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In the Supreme Court of the United States

OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY AND EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC., PETITIONERS

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET AL., RESPONDENTS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Whether the "filed rate" doctrine, reaffirmed by this Court in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), and *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), requires a state public utility commission to allow a utility to recover through its retail rates a fixed, unavoidable cost incurred by the utility pursuant to a contract with a pipeline embodied in a tariff approved by the Federal Energy Regulatory Commission.

2. Whether the retroactive application of a new ratemaking standard to bar a utility from recovering costs incurred by the utility prior to the adoption of the new standard, and previously recoverable, constitutes a taking of property without just compensation in violation of the Due Process Clause of the Fourteenth Amendment.

3. Whether a state public utility commission order directing a utility to hire separate and independent counsel to represent the interests of ratepayers in proceedings before the Federal Energy Regulatory Commission violates the utility's due process right to manage its legal affairs free from arbitrary governmental interference.

PARTIES TO THE PROCEEDING AND RULE 28.1 STATEMENT

In addition to the parties listed in the caption, Linda C. Taliaferro, Frank Fischl, and Bill Shane, commissioners of the Pennsylvania Public Utility Commission, and the Federal Energy Regulatory Commission were defendants in the district court and are respondents in this Court. The Office of the Attorney General for the Commonwealth of Pennsylvania and the Pennsylvania Office of the Consumer Advocate intervened below and are respondents in this Court. The American Gas Association participated below as *amicus curiae*.

Pursuant to Rule 28.1 of the Rules of this Court, petitioner Kentucky West Virginia Gas Company states that its parent company is Equitable Resources, Inc.; petitioner Equitable Gas Company states that it is a division of Equitable Resources, Inc. Petitioners' only other affiliate or subsidiary (other than wholly-owned subsidiaries) is Metscan Technology Partners, a partnership.

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v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET AL., RESPONDENTS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Kentucky West Virginia Gas Company and Equitable Gas Company, a division of Equitable Resources, Inc., respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-40a) is reported at 837 F.2d 600. The prior opinion of the court of appeals (App., *infra*, 80a-95a) is reported at 791 F.2d 1111. The opinion of the district court (App., *infra*, 41a-79a) is reported at 650 F. Supp. 659. The prior opinion of the district court (App., *infra*, 96a-104a) is reported at 620 F. Supp. 1458. The order of the Pennsylvania Public Utility Commission (App., *infra*, 107a-163a) is unreported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 105a) was entered on January 19, 1988, and a petition for rehearing was denied on February 16, 1988 (App.,

infra, 106a). Pursuant to orders issued by Justice Brennan, the time for filing a petition for a writ of certiorari was extended to and including July 15, 1988. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant provisions of the United States Constitution, the Natural Gas Act, 15 U.S.C. 717 *et seq.*, and Pennsylvania Act 74, 66 Pa. Cons. Stat. Ann. 1307(f), 1317-1318 (Purdon 1988 Supp.), are reprinted at pages 164a-175a of the appendix of this petition.

STATEMENT

The extent to which federal statutory and constitutional principles circumscribe state utility regulators has been a subject of considerable controversy in recent years. See, *e.g.*, *Schneidewind* v. *ANR Pipeline Co.*, 108 S.Ct. 1145 (1988); *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986); *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, 474 U.S. 409 (1986); see also *Duquesne Light Co.* v. *Barasch*, prob. jur. noted, No. 87-1160 (Mar. 7, 1988); *Northwest Central Pipeline Corp.* v. *State Corporation Comm'n*, prob. jur. noted, No. 86-1856 (May 23, 1988). In this case, intervention by this Court is necessary because respondents have transgressed federal limits upon their regulatory authority in a manner that, if not corrected, is likely to generate considerable confusion over the proper relationship between state and federal regulatory authority and to unsettle the expectations of public utility investors. Indeed, respondents' violation of federal law, sanctioned by the court of appeals, is virtually identical to the impermissible exercise of state regulatory power overturned by this Court in its recent decision in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988).

1. The Natural Gas Act, 15 U.S.C. 717 *et seq.*, authorizes the Federal Energy Regulatory Commission (FERC) to regulate both the interstate transportation of natural gas and sales of natural gas "in interstate commerce * * * for resale" (15 U.S.C. 717(b)). Under Sections 4 and 5 of the Act, 15 U.S.C. 717c and 717d, the Commission oversees the price and other terms of sales within its jurisdiction, evaluating rates and charges as well as all rules, regulations, practices, and contracts affecting those rates and charges, to determine whether they are just and reasonable.[1]

The Natural Gas Act allows the states to regulate the rates paid by retail natural gas customers (see 15 U.S.C. 717(b)), but, of course, such regulation is circumscribed by the duty to refrain from actions that contradict or undermine federal regulation. See, *e.g.*, *Mississippi Power*, slip op. 17 ("States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates"). This case involves an application by petitioner Equitable Gas to respondent Pennsylvania Public Utility Commission (PUC) for an increase in retail natural gas rates to reflect costs incurred by Equitable in purchasing natural gas at a federally-established rate during the period from July 1983 through December 1984.

Like other states and the FERC, Pennsylvania permits a utility to change its rates to reflect changes in fuel costs. Under Pennsylvania Act 74, which became effective on July 30, 1984, a utility is entitled to recover its

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[1] The Natural Gas Policy Act of 1978 eliminated price regulation of wellhead sales of "new" gas and established a timetable for the gradual decontrol of all wellhead sales. See generally *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 332-336 & n.14 (1983). That limitation upon the Commission's regulatory authority is not relevant in this case, which involves purchases by a regulated local distribution company from regulated interstate pipelines.

gas purchase costs only if it demonstrates that its gas purchasing decisions satisfied the new standard set forth in Act 74—"that the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers." 66 Pa. Cons. Stat. Ann. 1318(a) (Purdon 1988 Supp.).[2] If it is found, after application of the Act 74 standard, that the revenues received by the utility exceeded the allowable gas purchase costs, all of the excess revenues must be refunded to the utility's customers through rate reductions; conversely, if revenues were below allowable costs, the utility may recover the shortfall through increased rates (*id.* at § 1307(f)(5)).

2. Petitioner Equitable Gas Company sells natural gas at retail to approximately 240,000 consumers in and around the Pittsburgh, Pennsylvania area.[3] It obtains approximately 80% of its natural gas supplies through wholesale purchases from three interstate pipeline companies: Kentucky West Virginia Gas Company, which is an affiliate of Equitable; Texas Eastern Transmission Corporation; and Tennessee Gas Pipeline Company. Equitable purchases gas from these companies at rates and under terms and conditions set forth in tariff schedules approved by the FERC pursuant to its authority to regulate rates under the Natural Gas Act. App., *infra*, 3a-4a.[4]

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[2] Section 1318(a) provides that the PUC must make a number of specific findings before it concludes that a utility has satisfied this standard, including finding that the utility "fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission"; that, in the course of its dealings with its suppliers, the utility has "taken all prudent steps" to obtain low-cost gas supplies; and that the utility has not withheld low-cost gas from the market. Section 1318(b) provides that additional special findings are required when, as here, a utility has purchased natural gas from an affiliate.

[3] Equitable also serves consumers in West Virginia and Kentucky.

[4] Equitable obtains the remainder of its supplies from its own gas wells in Pennsylvania and West Virginia and from wells owned by independent producers in those states.

The period at issue in this case is July 1983 through December 1984 (all but five months of which preceded the effective date of Act 74). During that period, Equitable was bound by long-term contracts with the three pipelines; moreover, those contracts were themselves embodied in the pipelines' FERC-approved tariffs, under which the pipelines agreed to supply Equitable with specified volumes of gas at specified rates (usually expressed in dollars per thousand cubic feet). While Equitable could to some extent reduce the quantities of gas it purchased, the contracts and tariffs contained "minmum bill" provisions, under which Equitable was required to pay for a specified proportion of the gas to which it was entitled under its contract with the pipeline, whether or not it actually took delivery of the gas. See, *e.g.*, C.A. App. 903-940.[5]

During the early 1980s, there was a sharp decline in the demand for natural gas in Equitable's service area. As a consequence, beginning a year or more prior to the period covered by the application at issue in this case, Equitable's need for gas fell below the amounts it was obliged to purchase by virtue of the minimum bill obligations under its FERC-approved supply contracts. Equitable thereby became obligated to pay its interstate pipeline suppliers for gas not taken. Equitable responded by pursuing a strategy, in months when purchases were below minimum bill levels, of reducing the amounts of gas taken from each of its three pipeline suppliers on a pro rata basis. Equitable believed that such a strategy would result in the lowest cost for gas consistent with ensuring the company's access to reliable long-term gas supplies. App., *infra*, 21a; C.A. App. 263-264, 280, 364-365. This pro rata reduction purchase strategy was ap-

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[5] Minimum bill provisions have been extremely common in wholesale natural gas rates. For a discussion of the reasons that suppliers include minimum bill provisions in their tariffs, see *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1150-1151 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986).

proved by the PUC in connection with its review of Equitable's gas purchases for the period immediately preceding that at issue here. *Gas Rate Cost No. 5*, 58 P.U.R. 4th 369, 380 (Pa. P.U.C. 1984).[6]

On March 1, 1985, Equitable initiated a proceeding before the Pennsylvania Public Utility Commission seeking a rate increase on the ground that its actual gas costs during the period July 1983 through December 1984 exceeded its revenues. By its order, the PUC retroactively disallowed approximately $14.3 million of these purchased gas costs, which consisted entirely of purchases from petitioner Kentucky West Virginia Gas Company in partial satisfaction of Equitable's minimum bill obligation.[7]

The question on which the PUC focused was whether the costs incurred by Equitable in purchasing gas from its affiliate Kentucky West, more than two-thirds of which were incurred prior to Act 74's effective date, comported with Act 74's least-cost procurement standard.[8] Equitable contended that the purchases from Ken-

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[6] Equitable gave notice to the three suppliers that, in its view, the considerable oversupply of gas constituted *force majeure* that excused Equitable from its obligation under the minimum bill provisions of the suppliers' tariffs to pay for gas not taken. App., *infra*, 21a. Equitable's unilateral declaration of *force majeure* did not, of course, itself suffice to relieve Equitable of its legal obligation to make the minimum bill payments. See note 13, *infra*.

[7] In a second part of its application, Equitable sought increases in its future rates, based on its anticipated gas purchase costs for the period from September 1985 through August 1986. The PUC modified that request. It prospectively required Equitable to purchase quantities of gas from what the PUC found to be lower cost suppliers. Thus, the PUC directed Equitable to purchase more gas from Texas Eastern Transmission Corporation and decrease its projected purchases from Tennessee Gas Pipeline Corporation and from independent producers in the Hawks Nest area of West Virginia. App., *infra*, 119a-132a.

[8] The PUC rejected Equitable's contention that Act 74 could not be applied retroactively to assess the reasonableness of costs incurred prior to the Act's effective date. App., *infra*, 133a-137a.

tucky West met this standard because the minimum bill provision in Kentucky West's FERC-approved tariff required Equitable to pay for the Kentucky West gas whether or not it took delivery of that gas. App., *infra*, 140a. *Thus, even if Equitable had purchased gas from another supplier, the FERC-approved tariff required it to pay Kentucky West's minimum bill.*

The PUC found that the purchases from Kentucky West violated the least-cost purchase requirement of Act 74 because gas available to Equitable from its own production and from local suppliers was cheaper than the gas purchased from Kentucky West. It based this conclusion solely upon the basic rates charged by the various suppliers, ignoring both Equitable's obligation to pay Kentucky West under the minimum bill provision of the FERC-approved tariff and the impact of the minimum bill provision on the relative net costs of Equitable's sources of natural gas supply. Applying the standard set forth in Act 74, the PUC concluded that reducing the volumes of gas acquired from Kentucky West would have cut Equitable's costs by an amount greater than the $14.3 million in costs claimed by Equitable; it therefore declined to allow a rate increase to cover those costs. App., *infra*, at 142a-143a.

In the course of making the specific findings mandated by Act 74 concerning Equitable's purchasing strategy (see note 2, *supra*), the PUC considered whether Equitable had "fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission" (66 Pa. Cons. Stat. Ann. 1318(a)(1) (Purdon 1988 Supp.)). The PUC stated that, with respect to FERC proceedings to set the rates charged by Equitable's affiliate, Kentucky West, "[a] serious question arises as to whether [vigorous representation of the ratepayers' interests] can take place in view of Equitable's present corporate structure." App., *infra*, 148a. In order to eliminate what it found to be an obstacle to Equitable's performance of this statutory

duty, the PUC ordered Equitable to "obtain independent representation of its interest by legal counsel and technical support staff wholly separate from Kentucky West" in all FERC rate proceedings involving Kentucky West (*ibid.*).

3. Following the issuance of the PUC's order, Equitable, together with its affiliate, Kentucky West, commenced the present action in the United States District Court for the Middle District of Pennsylvania, joining as defendants the Pennsylvania Public Utility Commission, the members of that Commission, and the Federal Energy Regulatory Commission. Equitable sought declaratory and injunctive relief directing the PUC to allow Equitable to recover the $14.3 million in incurred gas costs and invalidating the portion of the PUC's order requiring Equitable to employ separate counsel to oppose the interests of an affiliated company, Kentucky West, in that company's FERC rate proceedings. C.A. App. 9-25.

The district court entered judgment in favor of respondents (see App., *infra*, 41a-79a).[9] It found that neither Act 74 nor the PUC's order violated the Supremacy Clause and that Act 74 did not violate either the Commerce Clause or the Equal Protection Clause.[10]

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[9] The district court had initially concluded that it should abstain so that Equitable's constitutional claims could be resolved in the state court proceeding (App., *infra*, 96a-104a). That determination was reversed by the court of appeals, which remanded the case for determination on the merits by the district court (*id.* at 80a-95a).

Equitable also filed a petition for review of the PUC's order in the Commonwealth Court of Pennsylvania. That court upheld the PUC's determination against several state-law challenges. See *Equitable Gas Co.* v. *Pennsylvania Public Utility Comm'n*, 526 A.2d 823 (Pa. Commw. 1987). Because of the pendency of the federal court action, Equitable did not press its federal claims in the state court proceeding.

[10] The district court declined to rule on Equitable's challenge to the portion of the PUC's order requiring Equitable to retain sepa-

The court of appeals affirmed (App., *infra*, 1a-40a). It first found that Act 74 was not facially invalid under the Supremacy Clause (*id.* at 12a-18a). (That ruling is not at issue here.) The court then turned to Equitable's argument that the manner in which the PUC applied Act 74 in this case violated the Supremacy Clause because it failed to recognize costs actually incurred by Equitable in taking delivery of Kentucky West gas that Equitable was bound under the FERC-approved tariff to pay for. The court of appeals recognized (App., *infra*, 19a) that Equitable's challenge to the statute as applied raised a substantial claim under this Court's decision in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), but it rejected Equitable's claim for two reasons. Invoking the general principle that federal courts should accord preclusive effect to factual determinations of state administrative agencies, the court deferred to the PUC's implicit conclusion that it was not necessary to consider the minimum bill provision of the FERC-approved tariff in assessing the prudence of Equitable's gas purchases (App., *infra*, 21a-22a). The court went on to reject Equitable's claim for the additional reason that Equitable had not "challenge[d] the evidentiary support for the PUC's findings" by introducing into evidence "mathematical figures * * * establishing what actual costs Equitable had incurred" pursuant to the Kentucky West minimum bill or what minimum bill costs Equitable would have incurred if it had purchased gas from the suppliers identified by the PUC (*id.* at 22a).

The court also rejected Equitable's claim that the PUC's retroactive application of the Act 74 standard to evaluate the reasonableness of gas costs incurred from July 1983 through July 1984—prior to the effective date of Act 74—constituted a taking of property without just

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rate counsel in future proceedings before the FERC, holding that Equitable's claim should be directed to the FERC (App., *infra*, 43a n.4).

compensation in violation of the Due Process Clause of the Fourteenth Amendment. According to the court, Equitable in effect waived the retroactivity objection when it "voluntarily" chose to make use of the Act 74 procedures rather than the statutory procedure for a general rate increase (App., *infra*, 35a).

Finally, the court of appeals held that the PUC did not violate Equitable's constitutional or statutory rights by ordering Equitable to employ separate counsel in future FERC proceedings. The court rejected Equitable's contention that the requirement of separate counsel violated its due process rights on the ground that "[t]he Supreme Court has not recognized a constitutional right to counsel in a civil case or in a civil matter before an administrative agency" (App., *infra*, 37a). The court also held that the PUC's order did not violate the right to assistance of counsel set forth in the Administrative Procedure Act (see 5 U.S.C. 555(b)). It found that the potential for conflict between the interests of Equitable's ratepayers and the interests of Kentucky West justified the requirement of separate and independent counsel to represent the ratepayers' interests before the FERC (App., *infra*, 38a-39a).

REASONS FOR GRANTING THE PETITION

In its recent decision in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), this Court reaffirmed that "States may not bar regulated utilities from passing through to retail customers FERC-mandated wholesale rates. '* * * When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate. . . . Such a 'trapping' of costs is prohibited.'" Slip. op. 17 (quoting *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 970 (1986)). The Court held

that a state could neither enter an order barring the recovery of FERC-mandated costs nor "undertake a 'prudence' review for the purpose of deciding whether to enter [such] an order" (slip op. 17).

The decision of the court of appeals erroneously sanctions the very "trapping" of costs found impermissible by this Court in *Mississippi Power*. Equitable was legally obligated by the minimum bill provision in Kentucky West's FERC-approved tariff to purchase the gas it did, but the PUC nonetheless refused to permit Equitable to recover the cost of those purchases on the ground that they were not prudently incurred costs. *Mississippi Power* holds that the Supremacy Clause bars a state from applying a state-law prudency standard to prevent a utility from recovering costs that the utility was obligated to incur under a FERC-approved tariff. In order to permit the court of appeals to take account of the subsequent decision in *Mississippi Power*, this Court should grant the petition, vacate the judgment of the court of appeals, and remand the case for reconsideration in light of that decision.[11]

The court of appeals failed to correct two other important errors committed by the PUC. First, the PUC applied Act 74's cost recovery standard retroactively, barring Equitable from recovering gas purchase costs incurred long before that statutory standard went into effect and thereby disrupting Equitable's reasonable expectations so as to effect a taking of property without just compensation. Second, the PUC ordered Equitable to engage separate and independent counsel to partici-

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[11] Substantial portions of the opinions below are devoted to the "facial" attack on Act 74, *i.e.*, the claims that *all* purchases of gas at FERC-approved rates are beyond state regulators' power to review for prudency. That claim is not renewed here. Rather, we focus solely on the power of the PUC to disallow costs incurred in purchasing gas that the utility is *obligated* by the FERC and by its contract with the pipeline to purchase.

pate in FERC ratemaking proceedings in opposition to applications by its affiliate, petitioner Kentucky West, in violation of Equitable's due process rights to manage its legal affairs free from arbitrary government interference. The court of appeals' erroneous disposition of these important constitutional issues also warrants review by this Court in the event the case is not remanded as suggested above.

A. The Court Of Appeals' Interpretation Of The Filed Rate Doctrine Conflicts With This Court's Decisions In *Mississippi Power* And *Nantahala*.

1. Section 4(a) of the Natural Gas Act, 15 U.S.C. 717c, endows the Federal Energy Regulatory Commission with exclusive authority to fix the just and reasonable rate for sales of natural gas in interstate commerce. *Arkansas-Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 (1981); see also page 3 & note 1, *supra*. This exclusive authority is safeguarded by what is known as the "filed rate" doctrine, which bars other tribunals from second-guessing the reasonableness of a rate fixed by the Commission. Thus, except for judicial review of the Commission's orders, federal courts may not conclude that the proper rate for a sale within the FERC's jurisdiction is anything other than the rate fixed by the FERC. *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-252 (1951). State courts are similarly bound to apply the Commission's determinations. *Arkansas-Louisiana Gas Co.* v. *Hall*, *supra*.

Most significant for purposes of the present case are this Court's decision two years ago in *Nantahala* and its recent decision in *Mississippi Power*. *Nantahala* concerned the proper allocation among related companies of entitlements to purchase low-cost electrical power. The FERC had issued a rate order allocating the low-cost power, but the state public service commission used a different allocation in fixing the rate to be charged to the utility's

retail customers. The question before this Court was whether the state commission's order violated the filed rate doctrine.

The Court explained that the "typical application" of the filed rate doctrine in this context occurs when "a middleman faces a FERC-fixed wholesale rate charged by a power supplier. In that situation, for a state rate-making agency to disregard a FERC-filed rate would clearly be inconsistent with the exclusive federal regulatory scheme over wholesale power prices" (476 U.S. 969). Accordingly, "[w]hen FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate" (*id.* at 970). The "state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price" (*id.* at 965). The Court stated that any other result would lead to the impermissible "trapping" of costs at the wholesale level, with the wholesaler obligated to pay the FERC-approved rate on the one hand, and unable to recover those costs in its retail rates on the other.

Although the facts of *Nantahala* did not involve a simple refusal to recognize a FERC-approved cost per unit of power, the Court nonetheless held that the state commission had violated the filed rate doctrine. The Court first observed that the doctrine remained applicable even though the FERC order did not set a monetary rate: "the filed rate doctrine is not limited to 'rates' *per se*: 'our inquiry is not at an end because the orders do not deal in terms of prices or volumes of purchases'" (476 U.S. at 966 (citation omitted)). Because the FERC order "directly affect[ed] Nantahala's wholesale rates by determining the amount of low-cost power that it may obtain, and FERC required Nantahala's wholesale rate

to be filed in accordance with that allocation," the Court concluded that the filed rate doctrine barred the state PUC from basing Nantahala's retail rates upon a different allocation of low-cost power (*id.* at 967).

Like *Nantahala*, *Mississippi Power* concerned the allocation among several entities of electrical power produced by a single plant. The FERC issued an order allocating 33% of the power to Mississippi Power & Light Co. (MP&L), and the state public utility commission permitted MP&L to increase its retail rates to recover the cost of purchasing that power at the FERC-approved wholesale rates. The state supreme court held that the commission erred because it should have reviewed the prudence of MP&L's decision to purchase power from the new plant before permitting MP&L to increase its retail rates to recover the cost of that power.

This Court reversed, holding that the state prudence review was preempted under the filed rate doctrine because the FERC allocation order compelled the state to permit the recovery of the cost of the power allocated to MP&L. "Just as *Nantahala* had no legal right to obtain any more low cost [electric] power than the amount allocated by FERC, it is equally clear that MP&L may not pay for less [high-cost electric] power than the amount allocated by FERC" (slip op. 19).

Application of the *Mississippi Power/Nantahala* principle in the present case is straightforward. The minimum bill provision in the Kentucky West tariff required Equitable to pay for at least two-thirds of the gas to which it was entitled under its contract with Kentucky West. It was not obliged to take actual delivery of this gas, but it was required to pay for it. Equitable thus had an unavoidable obligation, reflected in Kentucky West's FERC-approved tariff, to incur the expenses that the PUC found imprudent under Pennsylvania's least-cost pur-

chase requirement.[12] Since the minimum bill is part of Kentucky West's FERC-approved tariff, and "[o]nce FERC sets * * * a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable" (*Nantahala*, 476 U.S. at 966), the PUC was bound to conclude that the purchases from Kentucky West were reasonable and to permit Equitable to recover for them through its retail rates. The PUC's decision barring recovery of these payments results in the very trapping of costs at the wholesale level that the *Mississippi Power* and *Nantahala* Courts identified as the consequence of a violation of the filed rate doctrine: Equitable was obligated by Kentucky West's FERC-approved tariff to purchase the gas and to pay the rate set by the FERC, but Equitable was not permitted to recover those costs in its retail rates.[13]

Contrary to the apparent view of the court of appeals and the PUC, the PUC was not entitled to ignore the constraints of the filed rate doctrine because it was applying a state statute requiring review of the prudence of Equitable's gas purchase decisions. Indeed, this Court rejected just such a contention in *Mississippi Power*. This Court assumed that "it might well be unreasonable

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[12] True, because Equitable's actual purchases were *below* the minimum-bill level, they only partially satisfied Equitable's unconditional, federally-imposed obligation. But Equitable did not seek in this proceeding to recover costs beyond those actually incurred.

[13] Equitable's declaration of *force majeure* does not alter the analysis. First, the declaration related only to gas *not* purchased or paid for (see note 12, *supra*) and not to the purchases actually made in partial fulfillment of the contractual obligation; but it is only the latter that are at issue here. Second, Equitable's unilateral declaration did not vitiate the binding legal effect of the tariff. See, *e.g.*, *Equitable Gas Co.*, 28 F.E.R.C. ¶ 61,235 (1984); see generally 6 *Corbin on Contracts* §§ 1324-1329 (1962) (discussing standard governing proof of *force majeure*); *Nissho-Iwai Co.* v. *Occidental Crude Sales, Inc.*, 729 F.2d 1530, 1539-1542 (5th Cir. 1984) (same).

for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power" (slip op. 19). But, the Court continued, "if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced [electric] power that FERC has ordered it to pay for" (*ibid.*). Because the FERC order required MP&L to pay for all of the power allocated to it by the FERC, the state could not bar MP&L from recovering the full cost of that power through its retail rates.

Mississippi Power makes clear that, assuming a state utility commission may consider the prudence of a utility's purchasing decisions at all, that prudence inquiry is circumscribed by the filed rate doctrine. State regulators may find a utility imprudent in incurring particular costs only if the utility "had the legal right to refuse to [incur] that [cost]" (*Mississippi Power*, slip op. 19). In the present case, therefore, the PUC was not free to look *only* to unit prices of the various potential suppliers in assessing the prudence of Equitable's gas purchasing decisions. It also was obligated to take account of the fact that the minimum bill provision of Kentucky West's FERC-approved tariff required Equitable to pay for a certain minimum amount of gas each month.[14]

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[14] The Federal Energy Regulatory Commission agrees with this analysis. It stated in its brief in the court of appeals (at 47) that "to the extent that a state commission, in passing on the prudence of a retail distributor in buying from one source rather than another, disregards or ignores the economic consequences of a minimum bill in the wholesale rate schedule approved by FERC for that distributor's actual seller, the state is acting in violation of the 'filed rate' doctrine and thus outside its lawful regulatory authority."

The FERC did not take a position on the factual basis for Equitable's claim but stated that "if the facts are as [petitioners] allege then the Pennsylvania Commission's decision was inconsistent

The record clearly establishes that the PUC in fact ignored the minimum bill provision, in violation of the filed rate doctrine. First, the PUC's opinion never mentions the fact that the disallowed costs were incurred in satisfying a FERC-imposed duty to purchase gas from Kentucky West and pay the tariff rate for that gas. Second, the PUC's evaluation of the relative costs of alternative sources of supply is blind to the consequences of the minimum bill obligation. As long as Equitable's total gas purchases remained below minimum bill levels, as they did during the period in question, Equitable's true cost for gas purchased from a supplier other than Kentucky West was not simply the amount charged by that supplier. The cost of that gas would also include the minimum bill obligation that existed whether or not Equitable took gas from Kentucky West. For this reason, it is quite clear that, unless and until Equitable was relieved of its minimum bill obligation, purchasing gas from another supplier could never be cheaper than purchasing gas from Kentucky West. The PUC's contrary conclusion, without any mention of the minimum bill obligation whatsoever, conclusively demonstrates that it failed to take account of the minimum bill in assessing the relative cost of purchasing gas from a supplier other than Kentucky West.[15]

The court of appeals compounded the PUC's error. The court purported to recognize that Equitable might be entitled to relief under the filed rate doctrine if the PUC

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with controlling pre-emption doctrine" (FERC C.A. Br. 45). The FERC's reluctance to opine on the particulars of a dispute between private parties is understandable, but, as the discussion below makes clear, there can be little doubt that the PUC violated the filed rate doctrine.

[15] This conclusion is bolstered by the fact that the Public Service Commission of West Virginia, which expressly did take Equitable's minimum bill obligations into account, found that Equitable *had* been pursuing a lowest cost purchasing strategy. See C.A. App. 1068.

had failed to consider the minimum bill provision (see App., *infra*, 19a), but it went on to apply the doctrine in a manner that is squarely inconsistent with this Court's decision in *Mississippi Power*. The court held that Equitable had not properly raised its claim under the filed rate doctrine because Equitable had not established how the minimum bill provision was relevant to the costs disallowed by the PUC. The court found that Equitable's claim was precluded by the PUC's "finding", upheld by the Commonwealth Court, that the minimum bill provision was not relevant to the state-law prudence inquiry. *Id.* at 21a-22a.[16]

This Court's decision in *Mississippi Power* makes clear that state regulators' duty to take account of the provisions of FERC-approved tariffs does not depend upon the facts determined in the state-law prudence inquiry. The prudence inquiry is circumscribed by federal law, not vice versa. The decision below is wholly inconsistent with *Mississippi Power* because its allows state regulators to immunize their prudence determinations from scrutiny by making the "factual" finding that a FERC-approved tariff is not relevant in assessing the prudence of the utility's purchasing decisions. *Mississippi Power* makes clear that once the court of appeals determined that the minimum bill was part of the FERC-approved Kentucky West tariff, that court was obligated to conclude that the PUC had erred by failing to consider the effect of Equitable's minimum bill obligation on the prudency of Equitable's purchasing decisions.[17] Like the

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[16] Somewhat inconsistently, the court of appeals also faulted Equitable for allegedly failing to quantify its minimum bill liability in the district court. Of course, Equitable was not seeking relief with respect to its minimum bill obligation generally, but only with respect to the cost of federally required purchases actually made and paid for.

[17] In any event, Equitable plainly raised the connection between the claimed costs and the minimum bill before the PUC (see App., *infra*, 140a) and in the district court (see C.A. App. 268, 393-394, 424-425).

lower court in *Mississippi Power*, the court of appeals here simply failed to recognize that the filed rate doctrine requires state regulators to consider all of the provisions of FERC-approved tariffs when they evaluate the prudence of a utility's purchasing decisions.

2. The court of appeals did not have the benefit of this Court's decision in *Mississippi Power* at the time it decided this case. As we have discussed, the court below committed the same error as the lower court in *Mississippi Power* when it concluded that the PUC did not violate the Supremacy Clause by conducting its prudence inquiry outside the bounds permitted by the filed rate doctrine. For that reason, it is appropriate for this Court to grant this petition, vacate the judgment of the court of appeals, and remand the case to permit the court of appeals to reconsider its decision in light of the intervening decision in *Mississippi Power*.

Indeed, intervention by this Court is particularly appropriate because the application of the filed rate doctrine in the context of state statutes mandating review of a utility's gas purchasing decisions is a question of considerable importance.[18] Within the last five years more than a dozen states have, by statute or regulation, directed utilities to pursue least-cost purchasing strategies and required regulatory review of a utility's gas purchasing decisions. See Smoots, *Report on State Least-Cost Gas Purchasing Requirements*, 2 Natural Gas Lawyer's J. 110 (1987). The proliferation of state statutes mandating inquiries essentially identical to that conducted

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[18] The PUC's application of the Pennsylvania prudence statute, sanctioned by the court below, also conflicts with the approach advocated by other courts. In *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696, 705 (N.H. 1985), for example, the court recognized that a state commission was not free to ignore selected portions of a FERC-approved rate, but that "the FERC rate alternative [should be] compared in its entirety against other available options." See also *Commonwealth Electric Co.* v. *Department of Public Utilities*, 397 Mass. 361, 491 N.E.2d 1035, 1045 (1986).

by the Pennsylvania commission means that the frequency of these inquiries is likely to increase dramatically. The decisions of the court of appeals and the Pennsylvania PUC could create considerable confusion regarding the application of previously-settled federal principles in this new procedural context. They should not be permitted to stand.

B. The Retroactive Application Of Act 74's New Ratemaking Standard Effected A Taking Of Equitable's Property Without Just Compensation.

1. The Takings Clause of the Fifth Amendment, applied to the states through the Due Process Clause of the Fourteenth Amendment, limits government authority to regulate "rates chargeable from the employment of private property devoted to public uses." *FCC* v. *Florida Power Corp.*, 107 S.Ct. 1107, 1113 (1987). This Court has used the term "confiscatory" as a shorthand description of government rate orders that violate the Takings Clause (*ibid.*). The PUC acted in an impermissibly confiscatory manner by retroactively applying a new ratemaking standard to bar Equitable from recovering expenditures that met the prudency standards that applied at the time those expenditures were incurred.[19]

Equitable adhered to a consistent gas purchasing strategy during the period from 1982, when demand first fell below minimum bill levels, through 1984. It addressed its oversupply of gas by reducing the amount of gas obtained from its pipeline suppliers on a pro rata basis. See page 5, *supra*. Prior to the adoption of Act 74, the PUC applied the "just and reasonable" standard (see 66 Pa. Cons. Stat. Ann. 1301 (Purdon

[19] This argument applies to the portion of the PUC's order barring Equitable from recovering purchased gas costs for the period prior to the effective date of Act 74—July 1983 through July 1984. Equitable incurred approximately $12 million of the disallowed costs during this period.

1979)) to allow Equitable to recover gas purchase costs incurred for the year 1982. The PUC specifically found that Equitable had utilized "prudent gas supply management" in view of the constraints imposed by the minimum bill provisions in the tariffs of its pipeline suppliers. *Gas Cost Rate No. 5*, 58 P.U.R. 369, 380 (Pa. P.U.C. 1984).

In an about-face, the PUC did not apply the general "just and reasonable" standard to evaluate Equitable's application for a rate increase to cover gas purchase costs incurred from July 1983 through July 1984—the period at issue in the present case. Even though Act 74 did not become effective until July 30, 1984, after Equitable had incurred the expenses that it sought to recover, the PUC applied the new ratemaking standard set forth in that statute, concluding that Equitable's costs were not allowable under the new statutory standard and denying Equitable's application for a rate increase. The PUC thus applied the Act 74 standard retroactively to prevent Equitable from recovering costs that previously had been found to be recoverable under the standard in effect at the time those costs were incurred. Such a retroactive change in the standard governing recovery of out-of-pocket costs plainly violates the Takings Clause.

The effect of government action upon the reasonable expectations of investors is an important factor in analyzing the permissibility of a rate order under the Takings Clause. Thus, a court reviewing a rate order "must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable." *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968); see also *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) ("the return to the equity owner should be commensurate with returns on investments in other

enterprises having corresponding risks"). And the general standard for determining whether government action constitutes a taking looks in part to "the extent to which [the government action] interferes with investment-backed expectations." *Loretto* v. *Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 432 (1982); see also *Penn Central Transp. Corp.* v. *City of New York*, 438 U.S. 104, 124 (1978).

The key factor under all of these standards is whether the challenged government action upsets the investor's reasonable understanding of the risk that he assumed at the time he decided to make his investment. An important element of the investor's assessment of that risk in the context of a regulated company is the legal standard governing the company's ability to recover its out-of-pocket costs and earn a return on investment. Once the investor places his money at risk, he has an investment-backed expectation that the company's operations will be governed by the then-current legal standard. A prospective change in the legal standard does not interfere with this expectation—new investment will be withheld if the new standard increases risk without a commensurate increase in return.

A retroactive change in the applicable legal standard to bar recovery of previously-recoverable expenses or reduce the rate of return, however, raises serious issues. Because the additional risk that costs would be disallowed under changed regulatory policies was not known at the time the investment was made, the investor did not demand a rate of return commensurate with that risk.[20] Such a development not only causes the investor to lose the funds held to be nonrecoverable, but his remaining investment is riskier because more expenses

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[20] In this instance, the effect of the PUC's $14.3 million gas purchase cost disallowance was to reduce Equitable's rate of return on equity for the period in question to zero. C.A. App. 884.

could be retroactively disallowed in the future. For these reasons, a retroactive change in the governing legal standard, which bars recovery of costs incurred prior to the change in the legal rule although those costs previously had been recoverable, impermissibly interferes with investors' expectations in a manner that violates the Takings Clause.

The court of appeals concluded that Equitable waived its taking claim by "voluntarily" subjecting itself to the Act 74 standard, which the court thought could have been avoided by applying for a general rate increase rather than invoking the procedures for the recovery of gas purchase costs. See App., *infra*, 35a. The court's conclusion is wrong for the simple reason that the new Act 74 standard plainly applies to both types of ratemaking procedures. See 66 Pa. Cons. Stat. Ann. 1318(a) (Purdon 1988 Supp.). Accordingly, Equitable could not have avoided the injury it suffered by seeking a general rate increase.[21]

2. The question whether the Takings Clause permits the retroactive application of a new ratemaking standard to disallow costs that were recoverable under the ratemaking standard in effect at the time the costs were incurred is now before the Court in *Duquesne Light Co.* v. *Barasch*, No. 87-1160. The Supreme Court of Pennsylvania held in that case that a state statute barred utilities from recovering funds expended on the construction of nuclear power plants that were subsequently abandoned. The statute was adopted after the costs in question had been incurred, and the costs had been recoverable under the ratemaking standard in effect at the time they were incurred. The state court concluded that the

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[21] In addition, the applicable regulations *required* Equitable to use the purchased gas proceeding to seek a rate increase to recover actual gas costs in excess of revenues under its gas-cost tariff. See App., *infra*, 6a.

retroactive application of the new statute did not violate the Takings Clause.

The appellants in *Duquesne Light Co.*—like petitioners here—argue (see Br. 26-33) that the retroactive application of the statute effects a taking and that they are constitutionally entitled to recover through their retail rates out-of-pocket costs that were recoverable at the time they were incurred. In view of the close resemblance between the issue now before the Court in *Duquesne Light Co.* and the issue presented in this case, the Court should, if it does not remand on the *Mississippi Power* issue, hold the petition with respect to this question and dispose of it as appropriate in light of the disposition of *Duquesne Light Co.*

C. The PUC's Order Directing Equitable To Hire Separate Counsel Violates Equitable's Due Process Rights.

In alleged implementation of the duty imposed on Equitable by Act 74 to represent the interests of its ratepayers in FERC proceedings, the PUC ordered Equitable to retain separate counsel to participate in FERC proceedings in opposition to applications submitted to that body by Equitable's affiliate, Kentucky West. The court of appeals' conclusion that this extraordinary order comports with due process is inconsistent with the core function of the due process clause to guarantee "fundamental fairness." See, *e.g.*, *Walters* v. *National Ass'n of Radiation Survivors*, 473 U.S. 305, 320 (1985); *Lassiter* v. *Department of Soc. Services*, 452 U.S. 18, 24 (1981); see also *Joint Anti-Fascist Refugee Comm.* v. *McGrath*, 341 U.S. 123, 161 (1951) (Frankfurter, J., concurring) ("Fairness of procedure is 'due process in the primary sense' ") (citation omitted).

Although the process necessary to assure fundamental fairness varies depending on the circumstances, no process can be fair if it requires a participant to argue against its own perceived interests. Yet the PUC's order

does just that. It requires a parent company, Equitable Resources, to hire counsel to represent the customers of one of its subsidiaries, Equitable Gas, against its other subsidiary, Kentucky West. Such a procedure is totally unprecedented in Anglo-American jurisprudence. Indeed, this procedure

> misses a principle so plain and fundamental that I would think it would not need to be stated: Every citizen in this country is presumed to be unrestricted in consulting or employing an attorney on any matter, *or in making the decision that legal representation for any purpose is not needed.*

Walters, 473 U.S. at 371 n.22 (Stevens, J., dissenting) (emphasis added). "[T]he citizen's right to consult an independent lawyer and to retain that lawyer to speak *on his or her behalf* is an aspect of liberty that is priceless." *Ibid.* (emphasis added).

Although *Walters* ruled that Congress may establish informal administrative proceedings and discourage the participation of attorneys by limiting the amount they can be paid to a nominal sum, this Court has never held that a governmental body may force a party to appear at an administrative proceeding and, at the same time, require it to hire counsel to advocate a position that it does not wish to take. To the contrary, this Court has recognized that "lawyers, by training and disposition, are advocates and bound by professional duty to present all available evidence and arguments in favor of *their clients*' positions and to contest with vigor all adverse evidence and views." *Gagnon* v. *Scarpelli*, 411 U.S. 778, 787 (1973) (emphasis added); see also Friendly, "*Some Kind of Hearing*", 123 U. Pa. L. Rev. 1267, 1288 (1975) ("Under our adversary system the role of counsel is not to make sure the truth is ascertained but to advance his client's cause by any ethical means"); *Model Rules of Professional Conduct*, Rule 1.3, Comment (1983) ("A lawyer should act with commitment and dedication to the

interests of the client and with zeal in advocacy upon the client's behalf").

Because the PUC order is so totally at odds with Anglo-American legal tradition, it violates due process. See, *e.g.*, *Murray's Lessee* v. *Hoboken Land & Improvement Co.*, 59 U.S. (18 How.) 272, 277 (1856) (in determining whether a practice comports with due process, the court "must look to those settled usages and modes of proceeding existing in the common and statute law of England, before the emigration of our ancestors, and which are shown not to have been unsuited to their civil and political condition by having been acted on by them after the settlement of this country").

The PUC order also violates due process because it conflicts with substantive constitutional rights. See *Murray's Lessee*, 59 U.S. at 277 (in determining whether a practice violates due process, the court "must examine the constitution itself, to see whether this [practice] be in conflict with any of its provisions"). Specifically, because the PUC order requires Equitable to advocate a position with which it disagrees, the order impinges upon Equitable's First Amendment rights.

This Court has stated on several occasions that the protections of the First Amendment extend to speakers who have been compelled to disseminate or advocate views with which they disagree. See, *e.g.*, *Pacific Gas & Elec. Co.* v. *Public Util. Comm'n of California*, 475 U.S. 1, 16 (1986) (plurality opinion); *Harper & Row Publishing, Inc.* v. *Nation Enterprises*, 471 U.S. 539, 559 (1985); *Wooley* v. *Maynard*, 430 U.S. 705, 714 (1977); *Miami Herald Publishing Co.* v. *Tornillo*, 418 U.S. 241 (1974); *West Virginia State Bd. of Educ.* v. *Barnette*, 319 U.S. 624, 642 (1943); see also *id.* at 645 (Murphy, J., concurring). Thus, it is impermissible to "force[] speakers to alter their speech to conform with an agenda they do not set." *Pacific Gas*, 475 U.S. at 9

(plurality opinion). The speaker has "the right to be free from government restrictions that abridge its own rights in order to 'enhance the relative voice' of its opponents." *Id.* at 14 (citation omitted). Accordingly, "where the State's interest is to disseminate an ideology, no matter how acceptable to some, such interest cannot outweigh an individual's First Amendment right to avoid becoming the courier for such message." *Wooley*, 430 U.S. at 717.

The PUC's order is a pure example of impermissible compelled speech. The order requires Equitable to hire counsel to make arguments contrary to the interests of its sister company, Kentucky West. In other words, the order forces Equitable to make statements, through independent counsel acting on behalf of the ratepayers, with which it does not agree. Because the First Amendment fully applies to compelled speech, a governmental action requiring a person to disseminate information is constitutional only if it is a content-neutral and otherwise reasonable time, place, and manner restriction, *Pacific Gas*, 475 U.S. at 20-21 (plurality opinion), or if it is narrowly-tailored to achieve a compelling state interest. *Id.* at 19. The PUC order satisfies neither standard.

This Court's decision in *Pacific Gas* establishes that the order at issue here is not content-neutral. *Pacific Gas* involved an order of the California PUC requiring the appellant utility to include in its billing envelopes the newsletters of a consumer group that opposed it in ratemaking proceedings and with whose views it disagreed. The plurality held that the order was not content-neutral because it did "not simply award access to the public at large; rather, it discriminate[d] on the basis of the viewpoints of the selected speakers." *Pacific Gas*, 475 U.S. at 12 (plurality opinion). The order at issue here also discriminates on the basis of viewpoint. It requires Equitable to hire counsel to espouse a particular viewpoint, namely, one of support for ratepayers and opposi-

tion to Kentucky West's proposed tariffs. Therefore, like the order in *Pacific Gas*, the PUC order at issue here is not content-neutral.

The PUC order also fails the strict scrutiny test for governmental actions that discriminate on the basis of viewpoint. The State's interest in assuring low utility rates for its citizens may well be compelling. However, the order is not narrowly-tailored, because "the State can serve that interest through means that would not violate [Equitable's] First Amendment rights." *Pacific Gas*, 475 U.S. at 19. Specifically, in addition to FERC's own staff, consumer interests can be and are represented in FERC proceedings by state regulators. Indeed, both the PUC staff and Pennsylvania's Office of Consumer Advocate have taken active roles in ratemaking proceedings involving Kentucky West. There is no reason to think that Equitable's arguments in such FERC proceedings would add anything to those raised by the array of other advocates for the ratepayers' interests. Thus, requiring Equitable to finance two sets of attorneys and legal staffs to take opposing positions is in no way narrowly-tailored to achieve the State's interest in consumer protection.

In sum, the PUC's order requiring Equitable to hire attorneys to oppose Kentucky West in FERC tariff proceedings is neither content-neutral nor narrowly-tailored to achieve a compelling state interest. Therefore, the court of appeals' decision upholding it is inconsistent with this Court's First Amendment and due process jurisprudence.

CONCLUSION

The petition for a writ of certiorari should be granted, the judgment of the court of appeals vacated, and the case remanded for reconsideration in light of *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988). In the alternative, the Court should grant the petition or hold it for disposition as appropriate in light of the decision in *Duquesne Light Co.* v. *Barasch*, prob. jur. noted, No. 87-1160 (Mar. 7, 1988).

Respectfully submitted.

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In the Supreme Court of the United States

OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY AND EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC., PETITIONERS

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET AL., RESPONDENTS

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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APPENDIX A

UNITED STATES COURT OF APPEALS
THIRD CIRCUIT

No. 87-5052

KENTUCKY WEST VIRGINIA GAS COMPANY, EQUITABLE GAS COMPANY, a division of EQUITABLE RESOURCES, INC., AMERICAN GAS ASSOCIATION
(*Amicus Curiae Intervenor*),

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, TALIAFERRO, LINDA C., Commissioner, Pa. Public Utility Commission, FISCHL, FRANK, Commissioner, Pa. Public Utility Commission, SHANE, BILL, Commissioner.

Appeal of Kentucky West Virginia Gas Company and Equitable Gas Company, a division of Equitable Resources, Inc.

Argued Aug. 7, 1987

Decided Jan. 19, 1988

Rehearing and Rehearing In Banc
Denied Feb. 16, 1988

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Before SEITZ, MANSMANN and GREENBERG, Circuit Judges.

OPINION OF THE COURT

MANSMANN, Circuit Judge.

This is an appeal from an order of the district court which denied the plaintiff utility company's ("Equitable") request for injunctive and declaratory relief from an Order issued by the defendant Pennsylvania Public Utility Commission ("PUC"), applying Pennsylvania Act of May 31, 1984, No. 1984-74, 66 Pa.C.S.A. §§ 1307(f),

1317-18 (West Supp.1987), ("Act 74"), a statute enacted regarding utility rate regulation, 650 F.Supp. 659.

The principal questions we consider are whether the supremacy clause, the commerce clause and the due process clause of the United States Constitution prevent a state regulatory agency from determining the prudence of a gas company's choice to buy gas from one source rather than another before permitting the utility a "pass-through" to consumers of the cost of power purchased at wholesale rates approved by the Federal Energy Regulatory Commission ("FERC").

We concur with the district court's decision that a facial supremacy clause violation was not proven. Act 74 and the PUC Order implementing its provisions operate in an area exclusively reserved for state regulation; thus, principles of federal pre-emption are not involved. Although the district court did not address expressly the supremacy clause argument that the statute is unconstitutional as applied, we find no constitutional violation in this regard. We also approve the district court's conclusion that the action of the PUC was not in violation of the commerce clause because Act 74's impact upon the flow of interstate commerce is incidental in light of the legitimate local interest of consumer protection. We find no taking of property without due process. We also agree with the district court's determination that the plaintiff's right to counsel has not been abridged by the Order of the PUC. Finally, we decide that the district court did not abuse its discretion in limiting Equitable's request for discovery of communications between certain state agencies and members of the state legislature. We will affirm.

I.

The Historical Facts

Equitable Gas, a division of Equitable Resources, Inc., is a Pennsylvania corporation engaged in the production,

transportation, storage, distribution and sale of natural gas. The bulk of the gas necessary to serve Equitable's approximately 240,000 residential retail customers in Southwestern Pennsylvania is obtained from three sources, Tennessee Pipeline, Texas Eastern, and Kentucky West Virginia Gas, all interstate pipeline suppliers. Purchases of gas by Equitable from these pipeline sources are governed by tariffs set and approved by FERC. Equitable obtains the remainder of its gas either from its own wells in West Virginia and Pennsylvania or from independent producers.

Kentucky West Virginia Gas Company, also a plaintiff herein, ("Kentucky West"), is a wholly owned subsidiary of Equitable Resources, Inc. and sells to Equitable approximately 70% of the gas it produces.

On July 30, 1984, the Pennsylvania legislature enacted Act 74 dictating the mechanism by which natural gas distribution companies must establish retail rates for sales of gas to Pennsylvania consumers. Act 74 guidelines applicable to Equitable provide: "Natural gas distributors with gross intrastate operating revenues in excess of 40 million dollars may file tariffs reflecting increases or decreases in natural gas costs . . ., but no such natural gas utilities shall voluntarily file more than one such tariff in a twelve month period. . . ." § 1307(f)(1).

Once a tariff is filed, the PUC is then authorized to conduct an investigation to determine the reasonableness of the proposed rates. §§ 1307(f)(2), 1318. A proposed tariff will not become effective nor will it be deemed "just and reasonable" unless the PUC determines that the utility is pursuing a "least cost fuel procurement policy" consistent with its obligation to provide safe, adequate, and reliable service to its customers.[1]

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[1] The least-cost gas purchasing requirement has four elements. 66 Pa. C.S.A. § 1318(a)(1)-(4) reads:

> (a) General rule.—In establishing just and reasonable rates for those natural gas distribution utilities with gross intrastate

§ 1318(a). Particularly applicable to the Equitable-Kentucky West situation is the statutory direction that, if a utility purchases all or part of its natural gas from an affiliated interest, the PUC is required to make the following specific findings regarding the justness and reasonableness of gas purchases from the affiliate:

> (1) That the utility has fully and vigorously attempted to obtain less costly gas supplies on both short-term and long-term bases from nonaffiliated interests.

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operating revenues in excess of $40,000,000 under section 1307(f) (relating to sliding scale of rates; adjustments) or 1308(d) (relating to voluntary changes in rates) or any other rate proceeding, the commission shall consider the materials provided by the utilities pursuant to section 1317 (relating to regulation of natural gas costs). No rates for a natural gas distribution utility shall be deemed just and reasonable unless the commission finds that the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate reliable service to its customers. In making such a determination, the commission shall be required to make specific findings which shall include, but need not be limited to, findings that:

> (1) The utility has fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission.
>
> (2) The utility has taken all prudent steps necessary to negotiate favorable gas supply contracts and to relieve the utility from terms in existing contracts with its gas suppliers which are or may be adverse to the interests of the utility's ratepayers.
>
> (3) The utility has taken all prudent steps necessary to obtain lower cost gas supplies on both short-term and long-term bases both within and outside the Commonwealth, including the use of gas transportation arrangements with pipelines and other distribution companies.
>
> (4) The utility has not withheld from the market or caused to be withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

66 Pa. C.S.A. § 1318(a)(1)-(4).

(2) That each contract for the purchase of gas from its affiliated interests is consistent with a least cost fuel procurement policy.

(3) That neither the utility nor its affiliated interest has withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

§ 1318(b).

Finally, when the PUC seeks to render a "just and reasonable" determination under Act 74, § 1318(d) cautions that the fact that a FERC-approved contract or rate has been established for interstate purposes will not serve as per se satisfaction of the utility's burden of proof that the gas prices and volumes associated with FERC approval are just and reasonable for purposes of evaluating if a least cost fuel procurement policy has been followed.

On March 1, 1985, in conformity with § 1307(f) of Act 74, Equitable filed its "Annual Purchase Gas Adjustment" for the period of July 1983 through June 1984 in which it proposed a rate increase based upon wholesale costs incurred when procuring natural gas from its suppliers.

In response to Equitable's proposal of retail rates, the PUC initiated its Act 74 compliance inquiry, *i.e.*, whether Equitable had demonstrated pursuit of a least cost fuel procurement policy in obtaining the wholesale gas.

After a hearing by an Administrative Law Judge, the PUC found that Equitable had purchased gas from its affiliate, Kentucky West, when less expensive gas had been available from other sources and concluded that Equitable had not met its Pennsylvania statutory "just and reasonable" burden evidencing compliance with a least cost fuel procurement policy. Accordingly, the PUC denied Equitable the opportunity to pass through to con-

sumers approximately $14.3 million of Equitable's proposed rate increase, reflecting the amount paid for gas which the PUC found Equitable had imprudently overpaid for the gas purchased from Kentucky West. The PUC ordered additionally that Equitable employ counsel separate and independent from Kentucky West in future proceedings before FERC. Equitable sought review of this PUC Order before the Commonwealth Court of Pennsylvania.[2]

Equitable and Kentucky West also filed suit in federal district court challenging the constitutionality of Act 74. Equitable sought to enjoin the Commission from inquiring into its purchasing choices of natural gas from among competing gas suppliers. The rationale for this request was that FERC had approved the price of Kentucky West gas as "just and reasonable" [3] for purposes of federal law, and, therefore, the PUC did not possess the authority to disregard the federal approval in the state rate-setting proceeding. Equitable also sought a declaratory judgment that Act 74, enabling the PUC to disallow Equitable's purchased gas costs, was unconstitutional in light of the supremacy and commerce clauses and also that the PUC's Order represented an infringement upon other constitutionally-guaranteed rights.

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[2] In the appeal before the Commonwealth Court, Equitable withdrew the constitutional claims it had raised at the agency level and prepared its appeal solely on whether substantial evidence supported the PUC determination.

[3] Section 4(a) of the Natural Gas Act, 15 U.S.C. § 717c(a), empowers the FERC to determine the reasonableness of proposed rates:

> (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

A hearing on the appropriateness of preliminary injunctive relief was held, but the district court chose to abstain from exercising its jurisdiction. We reversed that determination, 791 F.2d 1111 (3d Cir.1986), and remanded the case to the district court for disposition on the merits. In December of 1986, after a hearing, the district court entered judgment in favor of the defendants. The district court found no constitutional violation in Act 74 on its face but did not address the argument that Act 74 was unconstitutional as applied to Equitable and Kentucky West by the PUC Order. The court also left unanswered the question of whether the PUC Order would abridge the plaintiffs' right to counsel in future proceedings before FERC, impliedly finding that the issue was not ripe for judicial disposition. This appeal followed.[4] On May 20, 1987, before argument of this appeal, the Pennsylvania Commonwealth Court rendered its decision affirming the PUC Order.

On appeal, Kentucky West and Equitable argue that Act 74 violates the supremacy clause of the United States Constitution. They argue that, because of pervasive federal regulation of wholesale pricing in the natural gas industry, Pennsylvania has no authority to compel Equitable to select the least expensive fuel available to it but must permit the utility to recover wholesale costs incurred at filed tariff rates. Equitable also argues that Act 74 is unconstitutional as applied by the PUC Order because it ignores Equitable's unavoidable, federally-

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[4] The Pennsylvania Attorney General and the Office of Consumer Advocate are intervenor defendants in this action. The Federal Energy Regulatory Commission is a named defendant, but their position is more akin to that of an amicus. In the district court proceeding, FERC filed a letter indicating its possible intention to participate in this matter on appeal and has now filed a brief outlining the federal agency's position on certain questions before us.

The American Gas Association (AGA) was permitted to participate in the suit as an amicus curiae. Hereinafter, unless otherwise noted, the defendants will be collectively referred to as the PUC.

approved, minimum bill obligation to Kentucky West. Equitable asserts that Pennsylvania's protection of its local interests, by permitting a pass-through only of the cost of the lowest priced gas, will indirectly and impermissibly affect the price of gas in other states in violation of the commerce clause. Equitable also alleges that the retroactive nature of the PUC's Order is a taking of property without due process. The plaintiffs also renew their contention that the PUC Order violates its right to counsel of their choice. Finally, the plaintiffs object to an order of the district court limiting the scope of their discovery of communications by members of the Pennsylvania legislature regarding their purpose in enacting Act 74.

Our review of the district court's findings of fact is governed by the clearly erroneous standard, while the conclusions of law based upon these facts are subject to our plenary review. The district court's decision limiting the content of Equitable's discovery involves an exercise of discretion and our review is then confined to whether there has been an abuse of that discretion. We have jurisdiction pursuant to 28 U.S.C. § 1291.

II.

A. *Preemption Generally*

We begin with Equitable's contention that the preemptive effect of the supremacy clause and the restraint of the commerce clause prevent a state regulatory agency from inquiring into the prudence of Equitable's choices among suppliers of gas. We preface our analysis of Equitable's arguments by outlining fundamental principles of preemption generally and as applied to retail and wholesale ratemaking.

The supremacy clause invalidates all state laws that conflict or interfere with an act of Congress.[5] *Rose v.*

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[5] The supremacy clause of the United States Constitution prohibits state actions which interfere with matters where the federal

Arkansas State Police, —— U.S. ——, 107 S.Ct. 334, 93 L.Ed.2d 183 (1986). Administrative regulations promulgated pursuant to Congressional authorization have the same preemptive effect as federal statutes. *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 104 S.Ct. 2694, 81 L.Ed.2d 580 (1984).

Under the supremacy clause, federal law may preempt state law in any of three ways; first, when in enacting federal law, Congress explicitly defines the extent to which it intends to preempt state law; second, when even in the absence of express preemptive language, Congress indicates an intent to occupy an entire field of regulation and has left no room for states to supplement the federal law; and, finally, when compliance with both state and federal law is impossible or when state law stands as an obstacle to accomplishment and execution of the full purposes and objectives of Congress. *Michigan Canners and Freezers Association, Inc., v. Agricultural Marketing and Bargaining Board*, 467 U.S. 461, 104 S.Ct. 2518, 81 L.Ed.2d 399 (1984); *Capital Cities Cable, Inc. v. Crisp, id.*

Even in the absence of preemptive legislation, the commerce clause bars state regulation that unduly burdens interstate commerce. The commerce clause acts as an implied restraint on state regulatory powers, which must give way before the superior authority of Congress to legislate on, or leave unregulated, matters involving interstate commerce. *United Building and Construction Trades Council of Camden County and Vicinity v. Mayor and Council of City of Camden*, 465 U.S. 208, 104 S.Ct. 1020, 79 L.Ed.2d 249 (1984).

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government has spoken. The seminal statement on preemption originated from Chief Justice Marshall in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 436, 4 L.Ed. 579 (1819): "States have no power . . . to retard, impede, burden or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government. . . ."

Prior to the enactment of the Natural Gas Act, 15 U.S.C. § 717, *et seq.* (1934) ("NGA") and the Federal Power Act, 16 U.S.C. § 791a *et seq.* (1935) ("FPA"), a series of decisions by the Supreme Court concerning the commerce clause outlined those areas of the utility industry in which the states were precluded from exercising regulatory authority. Congress subsequently expressed concern over the absence of state authority in wholesale sales when it became apparent that exploitative wholesale rates were being passed through to retail customers in the form of retail rates. *Arkansas Electric Coop. v. Arkansas Public Service Commission*, 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983). To close this gap in regulatory control, Congress enacted legislation tailored to supplement, not limit, the reach of state regulation. *Federal Power Commission v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 69 S.Ct. 1251, 93 L.Ed. 1499 (1949).

In *Montana-Dakota Utilities, Co. v. Northwestern Public Service Company*, 341 U.S. 246, 71 S.Ct. 692, 95 L.Ed. 912 (1951), the Supreme Court established what has since become known as the filed rate doctrine, *i.e.*, the rate filed with and approved by the Federal Power Commission (FERC's predecessor), is the only legitimate rate. The purchaser's right to a reasonable wholesale rate is the right to the rate which the Commission files or fixes. Except for a narrow review of the Commission's orders, the court can assure no right to a different rate on the ground that, in its opinion, another rate is the only or more reasonable one. Thereafter, in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 101 S.Ct. 2925, 69 L.Ed.2d 856 (1981), the doctrine was transformed into a rule of preemption under which state courts must recognize the inviolability of wholesale rates on file with or approved by FERC. Most recently, the Supreme Court in *Nantahala Power & Light Company v. Thornburg*, 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986), set the

current parameters of the filed rate doctrine by affirming a line of state court cases, exemplified by *Narragansett Electric Company v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972, 98 S.Ct. 1614, 56 L.Ed.2d 63 (1978), which held that state regulatory commissions must allow a retailer to recover at retail rates the cost incurred as a result of paying the FERC-determined wholesale price. Under these principles, states are preempted from questioning or altering the wholesale rates set by FERC. Hobelman, *The Narragansett Decision and Its Aftermath*, 6 Energy L.J. 33 (1985).

B. *The Supremacy Clause*

Given supremacy clause considerations, Equitable challenges the constitutionality of Act 74 both facially and as applied. Equitable alleges first that Act 74 and the PUC's Order enforcing it are preempted by the all-encompassing federal regulation of the natural gas industry.

Equitable does not challenge the Commonwealth's authority to set retail rates for intrastate supplies. It argues that Congress' regulation of wholesale rates is exclusive and that Act 74, under the guise of regulating the local distribution, intrudes upon that jurisdiction by indirectly affecting wholesale natural gas rates.

Section 1318(d) of Act 74 provides:

> The fact that a contract or rate has been approved by a Federal regulatory agency for interstate rate-making purposes shall not, in and of itself, be adequate to satisfy the utility's burden of proof that gas prices and volumes associated with such contract or rate are just and reasonable for purposes of this section.

Equitable argues primarily that § 1318(d) of Act 74 is unconstitutional because it permits the PUC to dis-

regard a lawful rate for interstate natural gas sales previously determined to be just and reasonable by FERC pursuant to its rate-setting authority established by federal statutes, the NGA, and the Natural Gas Policy Act, 15 U.S.C. § 3301, *et seq.* (1978), ("NGPA"). Equitable claims that, by its plain language, § 1318(d) violates the filed rate doctrine and unlawfully intrudes into the wholesale rate-making function exclusively within the jurisdiction of the federal government. It further alleges that the PUC Order applying Act 74 far exceeded Pennsylvania's jurisdiction over intrastate distribution and that the effect of denying the $14.3 million pass-through unlawfully invaded the wholesale natural gas ratemaking function, exclusively vested in the federal government. Equitable argues that the amount disallowed was incurred pursuant to the filed rate of its interstate pipeline supplier and prices established by the NGPA.

To the contrary, the PUC argues that preemption cannot be invoked because § 1318(d) is not an unconstitutional intrusion into the occupied field. It agrees that § 1318(d) does not permit the PUC to alter the filed rate, but asserts that it allows the PUC to compare actual gas purchases to available alternatives. The PUC challenges the applicability of the *Narragansett* doctrine here. Interpreting *Narragansett* to establish that a state authority has no jurisdiction to inquire into the reasonableness of the wholesale rate, the PUC counters that it did not alter, change, amend or review the reasonableness of any wholesale filed rate; rather, it only reviewed whether Equitable's choice among available wholesale rates demonstrated pursuit of a least cost policy. In the PUC's view, § 1318(d) does not permit it to analyze whether the wholesale rate itself is reasonable; § 1318(d) only allows a determination as to whether *purchases* are reasonable. If the volumes purchased were unreasonable in light of available alternatives, Act 74 forbids the excessive costs to be borne by Pennsylvania rate payers. The

PUC thereby concludes that its inquiry does not invade or threaten federal jurisdiction because it does not affect the wholesale filed rate.

Both sides cite the recent Supreme Court decision in *Nantahala Power & Light Company v. Thornburg*, *id.*, as support for their respective positions. In *Nantahala*, FERC was required to determine the state utility's entitlement to power and the Supreme Court determined that the North Carolina State Commission had overstepped its regulatory authority when it attempted to change that designated amount.

Equitable's interpretation of *Nantahala* is that it prohibits a state commission from penalizing a utility for purchasing gas at federally-approved rates during a prior period.

Equitable cites *Nantahala* as further support for the theory that a state may not directly or indirectly disallow the pass-through of FERC-approved purchased gas costs in the exercise of the regulation of local distribution. Equitable quotes from *Nantahala:*

> Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A state must rather give effect to Congress's desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.

Id. 106 S.Ct. at 2357.

The PUC interprets *Nantahala* to mean only that a state regulatory body is powerless to change a FERC determination that a state-regulated utility is entitled to a certain specified percentage of interstate-generated (and FERC-regulated) power. The PUC cites the following language as foreshadowing the case now before us and as indicative of how the Supreme Court would rule on the precise issue:

> Without deciding this issue, we may assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable *price*.

Id. at 2360. (Emphasis in original.)

The PUC concludes that § 1318(d) only states that purchasing any quantity of natural gas at a FERC-approved rate is not in and of itself proof that the total amount paid was not unreasonably excessive, when compared to available alternatives. The PUC acknowledges that *Nantahala* does not settle the issue, but asserts that the quoted dicta implicitly condones Act 74's overseeing of intrastate activity.

In its analysis of the facial constitutional challenge of Act 74 based upon the supremacy clause, the district court noted the dilemma of maintaining the proper balance between federal and state authority in the regulation of utilities and how this dichotomy of interests has presented a serious challenge to both judicial and Congressional wisdom. *Arkansas Electric, id.* The district court concluded, however, that Act 74 does not expressly conflict with the NGA because Act 74 purports on its face to operate only in an area which Congress has not preempted but, to the contrary, has expressly reserved to state control. The court noted that the statute explicitly reiterates a long-standing maxim of utility regulation jurisprudence, i.e., that states may legitimately exercise authority over intrastate utility rates. The court found that the statute and the PUC's Order lawfully focused upon the interstate retailer's purchasing options as they impacted upon intrastate rates and concluded that the Pennsylvania statutory scheme fell within that category of regulatory questions reserved for the states and in

accordance with the federal interest in insuring low prices for consumers.

The district court also held that preemption could not be inferred from an overall scheme of federal regulation. The court found that FERC jurisdiction does not comprehensively govern the field of utility regulation, rather, it complements the Commonwealth's control of the utility. The court likewise determined that federal interest in the area could not be classified as dominant, given the historical right of the states to exercise police power over utilities. In addition, the court found no physical impossibility in compliance with both the federal and the state regulations.

The district court concluded that the PUC's least cost policy review was not preempted because FERC's considerations are limited to whether a seller is charging a just and reasonable wholesale rate based upon its cost of service. FERC does not take the further step and decide whether that rate was the lowest available to a given purchaser.

We agree with the district court that FERC's rate-making determination does not govern the entire wholesale transaction. In regard to preemption by the NGA, we perceive no conflict of regulatory authority. While it is true that the NGA does not expressly preclude FERC from regulating the entire spectrum of a wholesale transaction, exclusive regulation is not the declared intent of the statute. Indeed, retail sales are specifically excluded from federal regulation by 15 U.S.C. § 717(b), and, accordingly, companies engaging only in retail sales are also necessarily excluded from regional regulation. Thus, we perceive significant support for the authority of states to review the prudence of a retailer's gas purchasing decision. The legislative history of the NGA confirms that the NGA was not intended to regulate the natural

gas industry comprehensively. H.Rep. 709, 75th Cong., 1st Sess. (1937); *Interstate Natural Gas Co., Inc. v. Federal Power Commission*, 331 U.S. 682, 690, 67 S.Ct. 1482, 1487, 91 L.Ed. 1742 (1947).

Regarding the states' traditional power to consider the prudence of a retailer's purchasing decision in setting retail rates, we find no reason why utilities must be permitted to recover costs that are imprudently incurred; those should be borne by the stockholders, not the rate payers. Although *Nantahala* underscores that a state cannot independently pass upon the reasonableness of a wholesale rate on file with FERC, it in no way undermines the log-standing notion that a state commission may legitimately inquire into whether the retailer prudently chose to pay the FERC-approved wholesale rate of one source, as opposed to the lower rate of another source.

We interpret *Nantahala* as preempting state commissions from questioning or altering the wholesale rate and compelling them to accept it when determining pass-through in their retail rate-setting procedures. In this way, the filed rate doctrine measures whether local retail rate-making activity interferes with federal authority over wholesale rates. Therefore, where a state commission violates the filed rate doctrine, this equates to an unlawful interference with federal authority over the same activity. *Id.* 106 S.Ct. at 2356.

Nonetheless, while *Nantahala* affirms that the PUC must accept the reasonableness of wholesale rates paid by a retailer, that does not end the inquiry or decide the issue in this case. The basic question before us is whether the PUC, without impugning the reasonableness of the wholesale rate, could consider whether Equitable prudently decided to incur the purchased gas cost from Kentucky West, even if procured at a FERC-approved rate.

We note that FERC's interpretation of its statutory authority[6] recognizes that wholesale rate-making does not as a general matter determine whether a purchaser has prudently chosen from among available supply options. FERC is called upon to pass upon the justness and reasonableness of wholesale rates and wholesale transactions, not whether a retailer acted prudently in making the purchase. If a distributor buys gas at wholesale and then sells it at retail, the state, not FERC, sets the rate for that second sale. In evaluating that retail rate under § 1318, the state should not be forestalled from considering the prudence of the distributor's purchased gas costs in establishing the cost of retail service. Since the question here of whether the retailer acted with economic prudence in purchasing from one wholesaler rather than another is never before FERC, the PUC is not regulating the same activity. Consequently we find no conflict between FERC's authority and that granted to the PUC on the face of Act 74.

We caution, however, that our rationale concerning the PUC's rate-setting authority should not be construed as finding that its regulatory jurisdiction is without limitation. An otherwise valid state law may not be applied in such a way as to interfere with a federal regulatory scheme. Equitable has also advanced as "an applied" constitutional challenge to Act 74 based upon the supremacy clause. The gravamen of its complaint in this regard is that the $14.3 million disallowance represented fixed and unavoidable costs incurred by the company. This characterization is premised upon Equitable's contention that it incurred these gas-purchasing costs

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[6] An agency's interpretation of its own authorization statute is entitled to some deference, constrained of course by our obligation to honor the clear meaning of a statute as revealed by its language, purpose and history. *Hi-Craft Clothing Co. v. N.L.R.B.*, 660 F.2d 910, 915 (3d Cir. 1981); *see also, Director, Office of Workers' Compensation Programs, United States Department of Labor v. Mangifest*, 826 F.2d 1318 (3d Cir. 1987) (Weis., J., concurring).

pursuant to its minimum bill contractual obligation with Kentucky West.[7]

Equitable claims that the PUC decided that Equitable should not have purchased gas from Kentucky West in favor of less expensive supplies without regard to the fact that Equitable would have had to pay for the gas in any event under the minimum bill contract. If that were in fact the case, we would not readily dismiss Equitable's theory of preemption. What is troubling are the facts, or more precisely, the absence of facts indicating that the specifics of this minimum bill obligation issue were properly presented to and adjudicated before the district court.

In its brief submitted to this court, Equitable advances the theory, indeed, centralizes the "as applied" constitutional argument, on its interpretation that the $14.3 million disallowed represented unavoidable costs since that amount was contractually due and owing to Kentucky West under its minimum bill contract.

The Office of Consumer Advocate ("OCA"), intervenor defendant, strongly challenged the foundation of this argument alleging that it represented both a factual misstatement and a legal mischaracterization. The OCA counters that the $14.3 million adjustment was unrelated to the minimum bill obligation.

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[7] The defined purpose of minimum bill contracts is to guarantee a long term supply of gas. In this instance, Kentucky West and Equitable are parties to a 20-year agreement which, by its terms, requires Equitable to purchase from Kentucky West a minimum amount of gas in exchange for which Kentucky West guarantees that that amount will be available for Equitable's consumption. Equitable is required to pay for a specified percentage (66⅔%) of its total contractual entitlement, regardless of actual consumption. The minimum bill contract and the wholesale rate of Kentucky West's gas were approved by FERC.

The PUC likewise questioned the integrity of Equitable's characterization of the $14.3 million. After the briefs were filed, the PUC presented a motion to strike those portions of Equitable's brief which defined the $14.3 million as an unavoidable minimum bill obligation. The PUC claimed that Equitable was raising this argument as a theory for relief for the first time on appeal and never argued this minimum bill question before either the PUC or the district court. The PUC further claims that this new theory represents a backdoor attempt to relitigate the PUC factfinding, a violation of the preclusive effect accorded by federal courts to factfinding of state agencies acting in their judicial capacity.

Equitable responded to the motion by strenuously arguing that characterization of the $14.3 million as a portion of their minimum bill obligation has been consistently and repeatedly set forth as the basis for their challenge of the PUC Order in all proceedings and requested a remand to present evidence probative of this claim.

In considering these statements of position and accompanying arguments, we first find that it was essential for Equitable to prove its theory, on the "ground floor," that the PUC's $14.3 million disallowance failed to take into account its minimum bill liability to Kentucky West since this is the only logical basis to support its "as applied" constitutional challenge to Act 74.

The district court disposed of Equitable's argument and the PUC's responsive contention that this theory equated to an attempt to relitigate the PUC's factfinding, by declining to inquire into the correctness of the PUC's activity in this matter. The rationale for this summary disposition was that the propriety of the utility commission's findings was not relevant to the district court's perception of the question before it—that being a challenge to the core authority of the PUC to engage in the

factfinding mission and not a challenge to the result of that expedition.

In conformity with our power of plenary review, we undertook a time-consuming analysis of the proceedings below to ascertain whether Equitable had raised the question of its minimum bill obligation in the context now developed on appeal. We conclude that Equitable failed to provide an analytic framework supporting an argument that the $14.3 million disallowance represented an unavoidable FERC-approved contractual obligation. The record simply does not demonstrate that any portion of the disallowed costs represented Equitable's minimum bill obligation.

The PUC found that, on June 30, 1983, Equitable invoked the *force majeure* clause in Kentucky West's tariff, reducing purchases to below minimum bill levels and announcing that it would pay only for gas taken. The PUC found that, for the period in question, Equitable had made no minimum bill payments to Kentucky West but had been pursuing settlement discussions in an attempt to reduce its minimum bill liability. At the time of the ratemaking under consideration here, no settlement agreement had been submitted to FERC for approval. The PUC found that no minimum bill costs had ever actually been incurred, and therefore declined to take them into consideration in setting the retail rate for the period in question. This uncertainty as to what minimum bill costs, if any, would *ever* be incurred by Equitable also justified the PUC's refusal to consider minimum bill liability in evaluating whether Equitable had pursued a least cost fuel procurement policy for the twelve month period under examination.

When a state agency acting in a judicial capacity resolves disputed issues of fact properly before it which the parties have had an adequate opportunity to litigate, federal courts must give the agency factfinding the same

preclusive effect to which it would be entitled in the state's courts. *University of Tennessee v. Elliott*, — U.S. ——, 106 S.Ct. 3220, 92 L.Ed.2d 635 (1986). To the extent that it is supported by substantial evidence, the PUC's factfinding is given preclusive effect in the Pennsylvania courts. *Metropolitan Edison Company v. Pennsylvania Public Utility Commission*, 62 Pa.Commw. 460, 437 A.2d 76 (1981). Equitable prosecuted its PUC fact-finding claim before the Commonwealth Court of Pennsylvania. On May 20, 1987, the Commonwealth Court affirmed the Order of the PUC:

> Here, the PUC reviewed the evidence and concluded that the gas costs were excessive and imprudently incurred. That conclusion was based on testimony indicating the known availability of less expensive gas which could have been taken in lieu of more expensive gas from Equitable's affiliate, Kentucky West. These findings are supported by substantial evidence, therefore we will not substitute our judgment for that of the PUC.

Equitable Gas Company v. Pennsylvania Public Utility Commission, —— Pa. Commw. ——, 526 A.2d 823, 831-82 (1987). We, therefore, give the PUC's factfinding preclusive effect.

In the district court Equitable did not challenge the evidentiary support for the PUC's findings. Instead, Equitable's witnesses merely testified before the district court that Equitable would have incurred "huge" minimum bill liability had the alternate supplies been purchased. However, Equitable did not offer any evidence to quantify this obligation. No mathematical figures were presented establishing what actual costs Equitable had incurred or would incur due to its minimum bill liability to Kentucky West, if it had purchased the gas from other suppliers in conformity with the PUC Order. Nor were any figures presented to indicate how mini-

mum bill obligations related to the purchased gas disallowed by the PUC. We find that establishment of these facts would be essential to support Equitable's claim of unlawful disallowance of a FERC-approved obligation.[8] The absence of any quantification leads us to conclude that Equitable failed to advance this theory for recovery at trial.

Accordingly, we find that the district court did not err in concluding that no supremacy clause violation occurred.

C. *The Commerce Clause*

The commerce clause,[9] empowering Congress to regulate commerce among the states, is a prolific source of competition between state and federal legislation. Certain areas of commerce have escaped potential federal regulation due primarily to their local character. *South Carolina State Highway Department v. Barnwell Brothers, Inc.*, 303 U.S. 177, 185, 58 S.Ct. 510, 514, 82 L.Ed. 734 (1938). States have traditionally been permited to exercise local control provided that they act within commerce clause-imposed restraints, and in, as a necessary adjunct, the absence of federal regulation to the contrary. *Raymond Motor Transportation, Inc. v. Rice*, 434 U.S. 429, 440, 98 S.Ct. 787, 793, 54 L.Ed.2d 664 (1978).

The limits of states' authority over matters of commerce have evolved from a series of Supreme Court decisions. The thread of concerns running through these cases is the peril of state activity resulting in local economic protectionism. This danger was expressed by the Supreme Court in *H.P. Hood & Sons, Inc. v. DuMond*,

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[8] Judge Seitz questions whether this issue is even a proper one in a supremacy clause context.

[9] All legislative powers . . . shall be vested in a Congress . . . [t]o regulate Commerce with foreign Nations and among the several States, and with Indian Tribes." Art. I § 8 cl. 3.

336 U.S. 525, 537-38, 69 S.Ct. 657, 664-65, 93 L.Ed. 865 (1949):

> This principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control of the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units. As the Court said in *Baldwin v. Seelig*, 294 U.S. 511, 527 [55 S.Ct. 497, 502, 79 L.Ed. 1032 (1935)], "what is ultimate is the principle that one state in its dealing with another may not place itself in a position of economic isolation."

The concern emerged into a per se rule of invalidity when state legislation was determined to encompass a defined goal of economic protectiontism. *City of Philadelphia v. New Jersey*, 437 U.S. 617, 98 S.Ct. 2531, 57 L.Ed.2d 475 (1978). An exemplification of legislation evidencing such an isolationist intent is a state law which patently subverts the flow of interstate commerce at its borders. *See, Welton v. Missouri*, 91 U.S. (1 Otto) 275, 23 L.Ed. 347 (1876).

Balancing factors do, however, exist. If credible objectives are advanced by local legislation and there is no overt discrimination against interstate trade, state commerce laws may survive commerce clause scrutiny. In these instances, the Court has fashioned a more flexible evaluation of state legislation, the general contours of which are outlined in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970), and reiterated in *Philadelphia v. New Jersey*:

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local

> benefits. . . . If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities."

Id. 437 U.S. at 624, 98 S.Ct. at 2535.

Equitable opines that Act 74 does not legislate over a legitimate local interest and argues to the contrary that the statute and the PUC Order applying its provisions constructed a wall against the interstate flow of natural gas. It characterizes Act 74 as protectionist in nature, subject to the "per se rule of invaldity." Equitable submits excerpts from the legislative history of the Pennsylvania statute and concludes that certain statements reveals unlawful local protectionism as its purpose. Equitable quotes the following statements of various legislators as evidence:

> Let us look at the possibility that this bill creates and the incentive it creates for those companies to drill in the State of Pennsylvania.
>
> * * * *
>
> Pennsylvania . . . has a considerable amount of gas underground that can be found, and it can be found at a much lower price than what they are talking about in the Gulf of Mexico and the transportation costs that are added to it . . . and this legislation reaches out to [interstate] pipelines. It reaches out to the transmission companies.

Pa.Legis.J.House at 1973 (Dec. 5, 1983). Another representative stated:

> If this bill pases, the utility companies are going to be under greater pressure to buy that Pennsylvania shut-in gas, which is going to be a good deal for

> Pennsylvania consumers as well as a good deal for the Pennsylvania oil and gas fields.

Pa.Legis.J.House at 1972 (Dec. 5, 1983).

Equitable construes these expressions as demonstrative of a discriminatory objective of benefitting Pennsylvania gas production while paying no heed to the federally-approved system of interstate natural gas pricing. Equitable argues that neither the proclaimed motive of protecting state consumers nor stimulation of in-state gas production can withstand commerce clause evaluation in light of the overall discriminatory tone of the Act.

To demonstrate uneven effects of Act 74, Equitable points to a series of alleged illegalities accomplished through application of the PUC Order. First, Equitable claims that segments of the PUC Order, reducing Equitable's purchases from Tennessee Gas, affects Tennessee's customers in 21 other states and consequently causes operational problems on the Tennessee system. Equitable asserts that these problems occur as a direct result of its reduction of purchases from the Tennessee system, because the increased costs on Tennessee's system are then allocated to its customers in other states. Equitable also contends that the PUC Order creates difficulties for Tennessee in acquiring new gas reserves. Equitable likewise claims that its pipeline supplier, Texas Eastern, will incur problems similar to Tennessee due to the PUC-mandated cutback of purchases from the Texas Eastern line.

Affiliate Kentucky West is claimed to be similarly affected by the PUC's application of Act 74 as it shifts fixed costs away from Pennsylvania consumers to Kentucky West's customers in other states. Equitable asserts that the Order creates potential operational problems for Kentucky West, a result highly unacceptable as Kentucky West is not subject to PUC jurisdiction. Equitable urges us to consider that any significant reduction in Equit-

able's purchases compelled by the PUC jeopardizes Kentucky West's service to its small municipal customers in Eastern Kentucky. This supposedly occurs because the Order's mandate to cut back affiliate purchases necessarily will reduce Kentucky West's takes from local producers in Virginia and Kentucky, potentially causing well shuttings, reservoir damage and potential loss of producing acreage. Equitable claims that minimizing Equitable's purchases from Kentucky West could impose serious cash flow problems that could jeopardize its interstate operations.

Finally on this issue, Equitable argues that in calculating the availability of alternate sources of gas the PUC Order imputed non-existent volumes on a cost-free basis which in fact did not exist. Using these volumes to justify the shift of purchasing away from Kentucky West, Equitable asserts, represents a blatant effectuation of unlawful economic protectionism.

As a corollary argument, stressing its analysis of the goal of the commerce clause as rescuing commerce from destructive consequences which result from conflicting legislation from many different states, Equitable claims it has suffered a "balkanization" [10] result. Equitable avers that a domino-effect situation has been manifested and points out that both the Pennsylvania PUC and the West Virginia Public Service Commission have reviewed their purchases for this relevant time period and arrived at two different conclusions. This, it alleges, exemplifies its exposure to different rulings from different jurisdictions which has already led to inequitable results.

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[10] The word "balkanization" was coined by Judge Becker in the earlier appeal during oral argument of the abstention issue in alluding to the possibility of multiple exposure to conflicting orders of varying regulatory bodies operating in a number of jurisdictions. *See* at ——.

In response to Equitable's avowal of a constitutional violation of the commerce clause, the PUC cites *Pike v. Bruce Church, id.*, referred to with approval in *Arkansas Electric Coop. v. Arkansas Public Service Commission, id.*, as the appropriate standard for commerce clause analysis in this case. The PUC claims that the "legitimate local public interest" language of *Pike v. Bruce Church* contemplates matters involving the general welfare of state citizens and that utility regulation is traditionally a proper subject for state regulation pursuant to the police power. The PUC then asserts that *Arkansas Electric* exemplifies its position that this authority to regulate utilities includes the power to regulate the intrastate retail sale of natural gas. Thus it argues that Act 74 is in conformity with the defined limits of the commerce clause in that the function of § 1318 is to permit the PUC to determine if volumes purchased at a particular rate were reasonable in light of available and competing alternatives, even after FERC has established that the interstate rate was just and reasonable. The PUC then concludes that part one of the *Pike v. Bruce Church* equation has been satisfied in that Act 74 effectuates a legitimate local concern in setting affordable retail natural gas rates, a concern of the ultimate consumer, compatible with the concerns of federal legislation.

In regard to the second prong of the *Pike v. Bruce Church* test, the PUC claims that the burden imposed on interstate commerce is minimal. It avers that Act 74 only regulates sales from Equitable to its Pennsylvania customers albeit through a process which necessarily involves review of Equitable's wholesale purchase but solely for the aim of effectively regulating Equitable's retail sales. The PUC assert that the only impact Act 74 has on interstate commerce is to stimulate a vigorous interstate market. In further support, the Commission opines that in the absence of Act 74 utilities would be free to purchase at a FERC-approved price, irrespective of the

effect on retail rates. By way of illustration the PUC claims that Equitable could purchase gas ignorant of lower price competing alternatives, secure in the knowledge that the PUC would be compelled to rubberstamp proposed retail rates to the extent they are in accord with FERC rates. This blind approval could result, it submits, merely because the proposed Equitable rate was identical to the FERC rate and despite the fact that FERC does not establish the intrastate retail rates. In essence, Equitable could assume that its wholesale choices were thoroughly unreviewable by state regulators. The PUC believes this position implicitly grants FERC substantial *retail* rate-making influence not contemplated by the NGA or the NGPA, all in an attempt to bypass traditional areas of state regulation.

In conclusion the PUC asserts that because Act 74 neither directly nor indirectly seeks to regulate any gas transaction in interstate commerce, and because the statute actually encourages competitive interstate gas markets, it poses no more than an incidental burden on interstate commerce.

As to the so-called balkanization situation, the PUC believes that this argument is misplaced. Citing the history of the perpetual conflict between local and federal regulatory bodies, *see Panhandle Eastern Pipe Line Company v. Public Service Commission of Indiana*, 332 U.S. 507, 523, 68 S.Ct. 190, 198, 92 L.Ed. 128 (1947), the PUC notes that this dual scheme has never created enough Congressional concern to generate legislative activity designed to promote uniformity of retail rate regulation. On the contrary, the PUC cites *Arkansas Electric* as expressly recognizing that the national fabric does not seem to have been seriously unraveled by reserving regulation of retail rates primarily to the jurisdiction of the states. The PUC refers to *Bibb v. Navajo Freight Lines*, 359 U.S. 520, 79 S.Ct. 962, 3 L.Ed.2d 1003 (1959), as a statement by the Court that the mere pos-

sibility of conflict between state regulatory considerations and goals of interstate commerce is not sufficient ground for invalidating a state law. Rather, actual conflict must exist which clearly impacts upon instrumentalities of commerce.

The district court evaluated the commerce clause issue by following the guidelines of *Pike v. Bruce Church.* The court then analyzed Equitable's evidence in support of a showing of an unlawful discriminatory effect on interstate commerce by Act 74 and rejected it in favor of the PUC's allegation that Equitable's evidence was speculative and inconclusive and demonstrated only a negligible impact on interstate commerce given the legitimate goal of protecting the local consumers from exorbitant utility rates.

The court then reviewed the history of natural gas regulation and referred to Congress' recent attempts at providing reasonable prices and adequate supply of gas to the consumers. The court then noted recently-enacted FERC Order 380 [11] as an attempt by the federal agency to carry the notion of price sensitivity into contractual relationships between producers, pipelines and distributors.

In light of this FERC-expressed sentiment, the district court opined that Act 74 "dovetailed nicely with the current federal attitude" and accomplished at the intrastate retail rate exactly what FERC was attempting to accomplish at the interstate level through enactment of FERC Order 380.

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[11] FERC Order 380, effective July 31, 1984 (therefore not applicable to the minimum bill issue presented herein), had the effect of eliminating variable costs (primarily the cost of purchased gas) from minimum bill commodity charges. The impact of this Order was to reduce the amounts due by virtue of these minimum bill contracts, as users will no longer be monetarily obligated for gas not taken.

The court then concluded that although the PUC's action may have some effect on interstate commerce, it was incidental as the legitimate local purpose advanced outweighed any burden imposed. The court further found that the PUC's action did not simplistically favor in-state gas producers over producers from other states; rather, the PUC operated evenhandedly to assure protection of the retail customer.

As to Equitable's "balkanization" argument, the district court likewise dismissed it as too speculative and found that Equitable failed to point with any specificity to any other regulatory proceedings which have resulted in an actual conflict with the PUC Order.

We agree with the district court that the commerce clause standard as defined by *Pike v. Bruce Church* controls the outcome of this issue. The crucial inquiry is whether Act 74 is basically a protectionist measure, operating in discriminatory disregard of interstate commerce, or whether it can fairly be viewed as a law directed to legitimate local concerns, accompanied by only an indirect burden upon interstate commerce.

The commerce clause requires that states exercise their regulatory authority not in a manner exhibiting purely local favoritism in commercial concerns nor in a manner detrimental to the national concern of the free flow of gas in interstate commerce. Act 74 withstands commerce clause scrutiny under this standard because we find no evidence to indicate that it poses more than an incidental burden on interstate commerce and find instead that the Act complements the federal goal of consumer protection.

Act 74 permits the PUC to compare a gas utility's actual purchases with available competing alternatives so as to assist the PUC's determination of whether a least cost policy has been pursued. In so doing, neither Act 74 nor the PUC order created any new loss or risk not traditionally associated with utility regulation. The statute

requires the utility to pursue a least cost fuel procurement policy; it does not require purchases from in-state producers except to the extent that the local producer is selling the least expensive fuel. Because the statute does not distinguish in terms of local producers and out-of-state producers, it does not violate the commerce clause.

In a multiple regulatory environment, there results an inevitable overlap when evaluating costs. This overlap, however, does not automatically trigger conflict because each regulatory body sets rates for only that portion of activity over which they possess jurisdiction. Undeniably, in an indirect manner, both FERC and the PUC will scrutinize costs beyond their jurisdictions; this crossing of lines is inherent in a regime of multiple regulation. What is critical is that both FERC and the PUC are later obligated to narrow their particular focus to set rates for only that segment of the utility services over which they have jurisdiction.

We likewise dispute Equitable's belief that the legislative history of Act 74 proves intent of an unlawful discrimination in its enactment. Reliance on legislative debate in interpreting the intent or meaning of a statute is contrary to Pennsylvania law, *see Commonwealth v. Alcoa Properties, Inc.*, 440 Pa. 42, 269 A.2d 748 (1970), and therefore the remarks of individual legislators cannot be binding as to legislative intent. *Hoffman v. Pennsylvania Crime Victim's Compensation Board*, 46 Pa. Commw. 54, 405 A.2d 1110 (1979). The motivation of particular members of the state legislature does not render a valid statute invalid. A court may even hypothesize motivations of a state legislature in order to find a legitimate objective promoted by the provision under attack. *Malmed v. Thornburgh*, 621 F.2d 565 (3d Cir.1980). Regardless, the remarks cited by Equitable seem to indicate only a desire for consumer protection, certainly a legitimate local interest.

As to Equitable's fear of the balkanization effect, although we acknowledge that the company's various activities certainly are subject to numerous regulatory bodies, we concur with the district court that Equitable's cry as to destructive consequences is speculative since it has produced no evidence probative of actual conflict.

III.

Due Process

On appeal Equitable raises for the first time the legal argument that the constitutional prohibition against the unlawful taking of property without due process was infringed by enactment of Act 74. Equitable cites as reversible error the district court's failure to consider the retroactive nature of the PUC Order, the zero return on equity resulting from the capitalization eventually approved by the PUC, and that the $14.3 million disallowed represented unavoidable costs incurred by Equitable. Alleging that the combined effect of these three elements equated to an unlawful taking, Equitable cites *Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923), for the proposition that to avoid being characterized as confiscatory utility rates must be sufficient to yield a reasonable rate of return. It argues further that the PUC Order unlawfully sets rates retroactively since the gas at issue already has been paid for and consumed prior to issuance of the Order.

The PUC does not deny the utility company's right to earn a fair return on property. It cites, however, its duty as a regulating authority to determine the fairness of the requested rate. *San Diego Land and Town Company v. Jasper*, 189 U.S. 439, 23 S.Ct. 571, 47 L.Ed. 892 (1903). The PUC also cites the landmark *Bluefield* decision but for a contrary reason, *i.e.*, to demonstrate that a utility's return generally should equate to that of businesses of comparable risk and uncertainty, and that:

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Id. 262 U.S. at 693, 43 S.Ct. at 679.

The PUC, noting its philosophy of requiring prudent management as a precondition to recovery of purchased gas costs, asserts that Equitable's purchase from Kentucky West did not reflect such sufficient and economical management as outlined in *Bluefield.* The PUC contends that if every utility rate-making disallowance could conceivably constitute an unconstitutional taking, the rate-making process would become a nullity.

Although the theory of a taking was not formally raised, the district court recognized it as inherent in Equitable's allegation that denial of the pass-through would reduce its return on investment to zero. The district court dispensed with the theory in a brief footnote, deciding that a regulated company cannot assert a due process claim when the prudence of its expenditures is at issue.

We agree with the district court that an imprudent managerial decision affecting the company's rate of return cannot serve as the basis for an argument that the PUC's rate-making rises to the level of confiscatory activity. We note that the PUC reviewed the evidence and concluded that Equitable had failed to exercise reasonable managerial prudence in the purchasing of its gas supplies. That conclusion was based on the Commission's finding that Equitable had made a conscious decision to purchase gas from Kentucky West when less expensive gas had been available from other sources. The Pennsylvania Commonwealth Court has affirmed that this finding of fact was supported by substantial evidence. Their

decision is res judicata. Consequently, disallowing the pass-through of the purchase price of the Kentucky West gas did not constitute confiscation.

With respect to Equitable's claims of retroactivity, we note that Equitable voluntarily chose the ratemaking procedure which would include historical as well as prospective data. Act 74, 66 Pa.C.S.A. § 1307, provides for adjustment of utility rates to reflect changes in the utility's purchased fuel costs without the considerably more extensive inquiry required under § 1308 governing approval of rate increases generally. This expedited procedure is a voluntary mechanism and the rate proceeding under § 1307 is instituted by the utility itself. The statute very clearly requires that the gas costs which may be passed through to consumers must meet the standards set out in § 1318. Consequently, before electing to proceed under that section, Equitable was on notice that its actual gas costs for the previous 12-month period would be subject to scrutiny regarding the utility's pursuit of a least cost fuel procurement policy, and that purchases from affiliates would be subjected to a higher level of scrutiny. Having elected to submit to this procedure, Equitable cannot now be heard to complain of its retroactivity.

Finally, with respect to the challenge to the disallowance of allegedly unavoidable costs, the only portion of the $14.3 million which could be characterized as unavoidable costs would be minimum bill charges actually incurred. As we noted previously, the PUC disallowed the pass-through based on its findings that the purchases from Kentucky West were imprudent, even though already below minimum bill levels, because cheaper gas was available from alternate suppliers, no minimum bill payments had ever been made to Kentucky West by Equitable, and the likelihood that such payments would ever be made was too speculative and uncertain to justify inclusion of them in Equitable's estimated cost of service.

Those findings were unchallenged before the district court, and the first finding above was affirmed by the Pennsylvania Commonwealth Court. Therefore, this record cannot support an inference that the costs were unavoidable.

IV.

Right to Counsel

We consider next Equitable's challenge to the PUC's direction to Equitable to employ counsel separate and independent from Kentucky West in further proceedings before FERC.

Act 74, 66 Pa.C.S. § 1317(a)(1), requires that, in determining whether a utility has pursued a least cost fuel procurement policy, the PUC is required to determine whether the utility has vigorously represented its rate payers in proceedings before the FERC. The PUC found it questionable whether such vigorous representation could occur in view of Equitable's corporate structure and ordered "[t]hat in its next § 1307(f) filing Equitable Gas Company certif[y]ied that it has employed separate independent counsel, with access to a technical staff separate and independent from its affiliated pipeline supplier, Kentucky West Virginia Gas Company, to represent it before the Federal Energy Regulatory Commission."

In a footnote, the district court noted Equitable's argument that this separate counsel directive violated its first amendment right of association, its right to petition the government for redress of grievances and denied due process rights. Yet the court declined to dispose of the issue, apparently deciding it was not ripe for adjudication. In refusing to address the issue, the district court instead noted that "the PUC may bring (the content of the directive) to the attention of FERC for whatever disposition FERC feels is appropriate if, and when, plaintiffs disregard the PUC's directive." *Kentucky West Vir-*

ginia Gas Co. v. Pennsylvania Public Utility Commission, 650 F.Supp. 659, 661 n. 4 (M.D.Pa.1986).

Equitable labels the district court's inaction as improper, alleging that it forced Equitable to disregard and, therefore, disobey, the PUC Order as a precondition to litigating its validity. Equitable cited *County Court of Ulster County v. Allen*, 442 U.S. 140, 99 S.Ct. 2213, 60 L.Ed.2d 777 (1979), as authority for the federal courts' duty to decide constitutional issues if necessary to dispose of the matter before them. On appeal, Equitable argues that joint representation of different entities which share a substantial interest is protected by the due process clause of the Fifth Amendment and that this protection extends to proceedings before federal agencies. Equitable also argues that the order violates its statutory right to counsel under the Administrative Procedure Act, 5 U.S.C. § 555(b).[12]

The PUC disputes Equitable's claim to a constitutional right to be represented by the same counsel as its affiliate, particularly when the interest of the affiliate could be in direct conflict with those of the utility.[13]

The Supreme Court has not recognized a constitutional right to counsel in a civil case or in a civil matter before an administrative agency. The statutory right to counsel under the Administrative Procedure Act has been construed to mean the right to counsel of one's choice.

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[12] The Administrative Procedure Act, 5 U.S.C. § 555(b) reads as follows:

> (b) A person compelled to appear in person before an agency or representative thereof is entitled to be accompanied, represented, and advised by counsel or, if permitted by the agency, by other qualified representative. A party is entitled to appear in person or by or with counsel or other duly qualified representative in an agency proceeding. . . .

[13] There has been no challenge to the PUC's jurisdiction to issue an order governing representation before FERC.

SEC v. Higashi, 359 F.2d 550, 553 (9th Cir. 1966). In addition, where the right to counsel exists, the due process clause of the fifth amendment does provide some protection for the decision to select a particular attorney. *United States v. Flanagan*, 679 F.2d 1072, 1075 (3d Cir. 1982), *rev'd on other grounds*, 465 U.S. 259, 104 S.Ct. 1051, 79 L.Ed.2d 288 (1984). That protection, however, "goes no further than preventing arbitrary dismissal of a chosen attorney, and providing a fair opportunity to secure counsel of one's choice." *Id.* Thus the right to counsel does not mean an absolute right to the lawyer of one's choice.

Inherent in the right to counsel is the right to the assistance of counsel unimpaired by conflicts arising from joint representation. The right to conflict-free representation may be waived in the interest in employing counsel of one's choice. *Id.* In fact, courts have held that joint representation must be permitted where the interests of a witness and a corporation are *common*, *i.e.*, the witness may be held responsible for the acts of a corporation and counsel for the corporation was also counsel most familiar with the source of the witness's vulnerability. *SEC v. Higashi*, 359 F.2d at 553. However, where there exists a potential for conflict, ordering parties to retain separate counsel violates neither due process nor the APA. *FTC v. Exxon Corp.*, 636 F.2d 1336, 1342 (D.C.Cir.1980).

The PUC Order was predicated on the finding that Equitable's interests in common with Kentucky West might be adverse to those of Equitable's rate payers whom it was Equitable's duty to represent before FERC. In support of its argument Equitable advanced an affidavit appended to its complaint averring, in essence, that the job of the general counsel of Equitable Resources will become more difficult by conformity with the PUC Order. However, the general counsel's affidavit also acknowledges

the potential for conflicting interest between Equitable and Kentucky West. This potential conflict served as one rationale for compelling separate counsel initially. The main rationale for the Order was that Equitable's congruence of interest with its affiliate wholesaler might compromise Equitable's statutory duty to represent its customers' interests in proceedings before the FERC.

We find no violation of federal law in the content of the PUC Order for separate counsel as raised before us.

V.

Discovery

We dispose of Equitable's claim regarding the district court's limiting the scope of discovery in short order. To find evidence in support of the claim that the enactment of Act 74 had the avowed unlawful purpose of discriminating against interstate commerce, Equitable sought discovery with respect to communications between the PUC, the Attorney General and the legislature during the period of deliberation of Act 74. The district court denied appellant's attempts to compel responses to these discovery requests. Equitable alleges that the denial was in error claiming that the district court abdicated its responsibility to examine all the facts and circumstances indicative of discriminatory animus on the part of the state law-making body and the PUC.

We review discovery matters by the abuse of discretion standard. *Public Loan Company v. Federal Deposit Insurance Corporation*, 803 F.2d 82 (3d Cir.1986). We have already addressed similar evidence of legislators' intentions (*see* p. 617) and concluded that under Pennsylvania law it was irrelevant. Equitable's desire to delve into communications between the legislature and the PUC and the Attorney General is beyond the necessary scope of discovery since the meaning and intent of Act 74 is clear. We find, therefore, that the district court

did not abuse its discretion in denying discovery related to inadmissible and irrelevant matters.

VI.

In accordance with the foregoing, we find neither Act 74 nor the PUC Order unconstitutional. We will, therefore, affirm the court's denial of injunctive and declaratory relief sought by Equitable.

APPENDIX B

UNITED STATES DISTRICT COURT
M.D. PENNSYLVANIA

Civ. A. No. 85-1514

KENTUCKY WEST VIRGINIA GAS COMPANY, and EQUITABLE GAS COMPANY, a division of EQUITABLE RESOURCES, INC.,
Plaintiffs,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, LINDA C. TALIAFERRO, FRANK FISCHL, and BILL SHANE, Commissioners, FEDERAL ENERGY REGLUATORY COMMISSION,
Defendants.

Dec. 23, 1986

Thomas & Thomas, Harrisburg, Pa., William A. Mogel, Ross, Marsh & Foster, Washington, D.C., for plaintiffs.

Eric N. Wise, Arlington, Va., for American Gas Assoc.

Joanne Leveque, Washington, D.C., for Federal Energy Reg. Com.

Charles Hoffman, Chief Counsel, Pa. PUC, Alphonso Arnold, Jr., Harrisburg, Pa., for defendants.

Michael Finio, Eugene Waye, Harrisburg, Pa., for Atty. Gen., intervener.

H. Kay Dailey, Robert P. Haynes, III, Harrisburg, Pa., for Consumer Advocate, intervener.

MEMORANDUM

CALDWELL, District Judge.

I. *Introduction.*

Plaintiff, Equitable Gas Company (Equitable), a division of Equitable Resources, Inc., produces, purchases, transports and sells natural gas in both interstate and intrastate commerce. As part of its business, it retails natural gas to approximately 240,000 customers in southwestern Pennsylvania. During the twelve month period ending June 30, 1984, Equitable purchased quantities of gas from one of its suppliers, Kentucky West Virginia Gas Company (Kentucky West), a wholly-owned subsidiary of Equitable Resources, Inc., to meet the demands of its Pennsylvania customers. In a subsequent proceeding before the Pennsylvania Public Utility Commission (PUC) Equitable sought to recover the cost of the purchased gas by increasing the rates charged to retail customers. The PUC disallowed the requested rates because it concluded that Equitable could have obtained less expensive gas from its own production and from quantities available from other suppliers. Equitable and Kentucky West thereafter filed this lawsuit, contending that the PUC action violated the commerce clause [1], the supremacy clause [2], and the first, fifth, and fourteenth amendments [3], along with two federal statutes, the Natural Gas Act (NGA), 15 U.S.C. § 717 *et seq.* and the Natural Gas Policy Act (NGPA), 15 U.S.C. § 3301 *et seq.* Plaintiffs

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[1] The commerce clause authorizes Congress to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3.

[2] The supremacy clause provides, in relevant part, as follows: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land, ..." U.S. Const. art. VI, cl. 2.

[3] U.S. Const. amend. I, V, and XIV, § 1.

seek a permanent injunction against the PUC, prohibiting it from inquiring into Equitable's choice of natural gas from among competing gas suppliers. This request is bottomed upon the approval by the Federal Energy Regulatory Commission (FERC) of Kentucky West's gas rates as just and reasonable for the purposes of federal law. Plaintiffs also seek, among other things, a declaratory judgment that the Pennsylvania legislation, the Act of May 31, 1984, Act No. 1984-74 (hereinafter "Act 74"), enabling the PUC to disallow Equitable's purchased gas costs is unconstitutional.[4]

A hearing on the appropriateness of preliminary injunctive relief was held on October 30, 1985. Thereafter, we abstained from exercising our jurisdiction. *See Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Commission*, 620 F.Supp. 1458 (M.D.Pa. 1985). The Court of Appeals for the Third Circuit reversed that determination, 791 F.2d 1111 (3d Cir.1986), and remanded the case to us for a disposition on the merits. A hearing was held for that purpose on August 21, 22 and 28, 1986 and thereafter the parties briefed the issues which are now ripe for disposition. For the reasons set forth below, we will grant judgment in favor of defendants on all of the plaintiffs' claims.[5]

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[4] The PUC also directed plaintiffs to retain separate counsel and support staffs in future appearances before the Federal Energy Regulatory Commission (FERC). Plaintiffs alleged that this action violated their first amendment right of association and to petition the government for redress of grievances as well as denied them due process. We will not dispose of this issue because the PUC may bring it to the attention of FERC for whatever disposition FERC feels is appropriate if, and when, plaintiffs disregard the PUC's directive.

[5] We will not do so for the legal representation issue referred to in footnote 4, *supra*.

II. *Background.*

From the testimony at the hearings and the stipulation of facts that the parties have been able to agree upon, the following is the background of this litigation.[6]

As noted previously, Equitable sells natural gas at retail in southwestern Pennsylvania. It has approximately 240,000 customers in Pennsylvania which include residential and industrial users. Equitable also retails gas in West Virginia and Kentucky on a much smaller scale. Its West Virginia customers number 11,000 and its Kentucky customers approximately 4,000. Equitable's retail sales in these three states are regulated by the appropriate state administrative body; in Pennsylvania, the PUC, in West Virginia, the West Virginia Public Service Commission, and in Kentucky, the Kentucky Public Service Commission. These retail sales are not subject to FERC approval.

Equitable has three main sources of gas. First, Equitable has its own production from wells it controls in West Virginia and Pennsylvania. Second, gas is acquired from independent producers in those states under contracts with Equitable. Third, Equitable receives gas from three interstate pipelines, Kentucky West, Texas Eastern Transmission Corporation (Texas Eastern) and Tennessee Gas Pipeline Company (Tennessee).

Kentucky West, Texas Eastern and Tennessee, natural gas companies under section 1 of the NGA, 15 U.S.C. § 717, sell gas in interstate commerce. They receive supplies of gas from producers at the wellhead. FERC controls the pipelines' tariffs. That federal agency approves many different tariffs for the sale of natural gas and the price at which gas is sold under each tariff may be

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[6] This "Background" section and the "Discussion" section which follows constitute our findings of fact and conclusions of law in accordance with Fed. R. Civ. P. 52.

different. Approval of the tariffs, or rates at which a pipeline sells gas, does not guarantee the pipeline any particular sales volume. Kentucky West sells approximately 70% of its gas to Equitable.

Equitable has long term contracts with each of its interstate pipeline suppliers. The contracts contain the following two provisions, typically included in contracts for the wholesale purchase of natural gas. One provision entitles Equitable to purchase a maximum amount of gas per day, "a maximum daily volumetric entitlement." The other provision is a "minimum commodity bill," requiring Equitable, for a portion of the period relevant to this action, to pay the full commodity charge for a minimum volume of gas regardless of whether Equitable actually needs or wants the gas.[7] A minimum commodity bill does not require Equitable to physically take the gas paid for. *See Wisconsin Gas Co. v. FERC*, 244 U.S.App. D.C. 349, 758 F.2d 669, 672 (D.C.Cir.1985) (per curiam).

The minimum commodity bill is similar to a provision pipelines have in their own contracts with producers of natural gas. Called a "take or pay" provision, it "require[s] a pipeline to take a specified percentage of the gas which it is contracturally obligated to purchase, or to pay for such gas." *Id.* at 673 n. 8 (brackets added).

As noted previously, Equitable made certain purchasing decisions during 1983 and 1984, taking from among the sources of gas available to it, a certain quantity from its affiliated pipeline, Kentucky West. On March 1, 1985, Equitable sought approval of new rates for its retail customers in Pennsylvania by filing a computation of Annual Purchased Gas Adjustment pursuant to 66 Pa. Con.Stat. § 1307(f)(1), a part of Act 74.

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[7] As will be shown below, FERC has acted to prevent pipelines from recovering variable costs in minimum commodity bills. FERC also recently acted to eliminate completely the minimum commodity bill from Tennessee's contracts.

The PUC investigated the justness and reasonableness of the new rates pursuant to section 1307(f)(2) and under the standard promulgated in 66 Pa.Con.Stat. § 1318.[8] It concluded that Equitable had not pursued "a least cost fuel procurement policy" as required by section 1318, and that its proposed rates were accordingly not just and reasonable. Specifically, in an opinion and order, adopted August 28, 1985, the PUC concluded that Equitable, for the period between July 1, 1983 and June 30, 1984, had unnecessarily purchased more expensive gas from Kentucky West when it had available to it lower priced local production and its own supplies. It imputed to Equitable the purchase of the less expensive gas and disallowed the rates it had requested based upon its actual gas purchases. This action resulted in a failure to recover $14.3 million in purchased gas costs for gas already delivered to and consumed by Pennsylvania customers. The PUC also concluded for the then upcoming period between September 1, 1985 and August 31, 1986,

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[8] That section, which is applicable to Equitable because it has over forty million dollars in intrastate operating revenues, provides, in pertinent part, that: "[n]o rates for a natural gas distribution utility shall be deemed just and reasonable unless the commission finds that the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers." In making that determination, the PUC must make specific findings, including, among others, that: "[t]he utility has taken all prudent steps necessary to negotiate favorable gas supply contracts and to relieve the utility from terms in existing contracts with its gas suppliers which are or may be adverse to the interests of the utility's ratepayers," that "[t]he utility has taken all prudent steps necessary to obtain lower cost gas supplies on both short-term and long-term bases both within and outside the Commonwealth," and that "[t]he utility has not withheld from the market or caused to be withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy." See 66 Pa. Con. Stat. § 1318(a). (brackets added). The PUC must make other specific findings when purchases have been made from an affiliate. *Id.* at subsection (b).

that Equitable should increase its purchases from Texas Eastern and reduce purchases from Tennessee. Concerned about the close corporate relationship between Kentucky West and Equitable, the PUC also ordered those entities to retain separate counsel and separate support staff in Kentucky West's future FERC proceedings. This lawsuit followed.

In the meantime, Equitable has complied with the PUC Order. It has reduced its purchases from Tennessee and increased its purchases from independent gas producers in Pennsylvania and West Virginia.

III. *Discussion.*

A. *Act 74 Does Not Violate the Supremacy Clause.*

We preface our discussion of the supremacy clause claim with the following remarks by the Supreme Court on the "dilemma" often presented by federal and state regulation of utilities:

> Maintaining the proper balance between federal and state authority in the regulation of electric and other energy utilities has long been a serious challenge to both judicial and congressional wisdom. On the one hand, the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States. *See Munn v. Illinois*, 94 US [4 Otto] 113, 24 L Ed 77 (1877). On the other hand, the production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests. See *FERC v Mississippi*, 456 US 742, 755-757, 72 L Ed 2d 532, 102 S Ct 2126 [2135-36] (1982); *New England Power Co. v New Hampshire*, 455 US 331, 339, 71 L Ed 2d 188, 102 S Ct 1096 [1100] (1982).

Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n, 461 U.S. 375, 377, 103 S.Ct. 1905, 1908-09, 76 L.Ed.2d 1, 6 (1983).

We turn now to the supremacy clause claim and note that it must be judged against the following standard:

> It is a familiar and well-established principle that the Supremacy Clause, US Const, Art VI, cl 2, invalidates state laws that "interfere with, or are contrary to" federal law. *Gibbons v Ogden*, 9 Wheat 1, 211, 6 L Ed 23 (1824) (Marshall, C.J.). Under the Supremacy Clause, federal law may supersede state law in several different ways. First, when acting within constitutional limits, Congress is empowered to pre-empt state law by so stating in express terms. *Jones v Rath Packing Co.*, 430 US 519, 525, 51 L Ed 2d 604, 97 S Ct 1305 [1309] (1977). In the absence of express pre-emptive language, Congress' intent to preempt all state law in a particular area may be inferred where the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress "left no room" for supplementary state regulation. *Rice v Santa Fe Elevator Corp.*, 331 US 218, 230 91 L Ed 1447, 67 S Ct 1146 [1152] (1947). Preemption of a whole field also will be inferred where the field is one in which "the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject." *Ibid.*; see *Hines v Davidowitz*, 312 US 52, 85 L Ed 581, 61 S Ct 399 (1941).
>
> Even where Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent that it actually conflicts with federal law. Such a conflict arises when "compliance with both federal and state regulations is a physical impossibility," *Florida Lime & Avocado Growers*,

> *Inc. v Paul*, 373 US 132, 142-143, 10 L Ed 2d 248, 83 S Ct 1210 [1217-18] (1963), or when state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," *Hines v Davidowitz*, supra, [312 US 52], at 67, 85 L Ed 581, 61 S Ct 399, [at 404]. See generally *Capital Cities Cable, Inc v Crisp*, 467 US 691, 698-699, 81 L Ed 2d 580, 104 S Ct 2694 [2700] (1984).

Hillsborough County v. Automated Medical Laboratories, Inc., 471 U.S. 707, 712-714, 105 S.Ct. 2371, 2375, 85 L.Ed.2d 714, 721 (1985); *see also Cipollone v. Liggett Group, Inc.*, 789 F.2d 181 (3d Cir.1986), *petition for cert filed*, 55 U.S.L.W. 3364 (U.S. Oct. 6, 1986) (No. 86-563).

Plaintiffs claim that Act 74 conflicts with federal law because it permits Pennsylvania to regulate indirectly the price of Kentucky West's gas in interstate commerce. They point specifically to section 1318(d) as being unconstitutional on its face.[9] That section provides as follows:

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[9] On the morning of trial plaintiffs amended their responses to include a facial attack upon 66 Pa.Con.Stat. § 1318(a). The Attorney General filed a motion to exclude the issue, which was denied at the hearing. We will deny the Attorney General's companion motion for sanctions.

There are other outstanding motions we should deal with at this juncture. The PUC and Office of Consumer Advocate have filed a motion in limine, trying to prevent relitigation of certain issues decided adversely to plaintiffs in the proceedings before the PUC. Plaintiffs oppose the motion. All parties discuss the matter in terms of the collateral estopel and res judicata effects of the agency proceedings. Plaintiffs did introduce some testimony going to the merit of the PUC's fact-finding, but regardless of the reasons set forth in the motion in limine, we have decided not to inquire into the correctness of the PUC findings in the context of this case. Plaintiffs are challenging the very authority of the PUC, in light of federal constitutional and statutory provisions, to inquire into

> Other regulatory approvals.—The fact that a contract or rate has been approved by a Federal regulatory agency for interstate ratemaking purposes shall not, in and of itself, be adequate to satisfy the utility's burden of proof that gas prices and volumes associated with such contract or rate are just and reasonable for purposes of this section.

Plaintiffs claim that the statutory refusal to recognize a rate established by a federal agency is improper. We disagree. "It is well established that the courts will not invalidate a statute on its face simply because it *may* be applied unconstitutionally, but only if it *cannot* be applied consistently with the Constitution." *Robinson v. New Jersey*, 806 F.2d 442, 446 (3d Cir.1986) (emphasis in original). Section 1318(d) can be applied constitutionally because it merely recognizes explicitly what has been accepted for decades in utility regulation jurisprudence—that states may legitimately exercise authority over intrastate utility rates. *See Arkansas Electric, supra.* Hence, the refusal to accept federal approval of interstate rates is valid because Act 74 is intended to reach only intrastate rates. The use of the phrase, "just and reasonable" in both federal law, see 15 U.S.C. §§ 717 c(a), 717d(a), and state law is irrelevant when the jurisdictional reach of the laws is different. Section 1318(d) is not unconstitutional on its face.

Plaintiffs and the amicus, American Gas Association, rely heavily upon *Nantahala Power And Light Co. v. Thornburg*, —— U.S. ——, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986) to buttress their contention that Act 74 vio-

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Equitable's purchased gas costs. Whether the PUC was correct in its factfinding is irrelevant to the inquiry we must make. Accordingly, the motion in limine will be dismissed as moot.

The PUC has also filed a motion to amend its answers to paragraphs 23 and 25 of plaintiffs' complaint. Plaintiffs have opposed this motion. We believe the motion has come too late and we will deny it.

lates the supremacy clause and is in conflict with the NGA.[10] In their view, the Supreme Court held in *Nantahala* that "state regulators must recognize that wholesale energy costs incurred by local utilities are reasonable and prudent as a matter of law." (Kentucky West's and Equitable's initial brief at p. 29). We find no support in *Nantahala* for this expansive reading of the opinion.

In *Nantahala*, the Nantahala Power & Light Company (Nantahala) and Tapoco, Inc. (Tapoco), wholly owned subsidiaries of Alcoa, each owned hydroelectric plants on the Little Tennessee River and surrendered all the power generated by the plants to the Tennessee Valley Authority (TVA). In return, both received a fixed supply of low cost "entitlement power," and Nantahala could purchase a variable amount of high cost "purchased power." Nantahala served retail and wholesale customers. Tapoco sold all its power to Alcoa.

Certain agreements between TVA, Nantahala and Tapoco, conferred upon Tapoco 80% of the entitlement power and upon Nantahala 20%. In 1976, Nantahala filed a proposed wholesale rate increase with FERC. Upon objection by a wholesale customer, FERC determined that the allocation of entitlement power was unfair and that Nantahala should receive 22.5% of that power. FERC therefore required Nantahala to file rates which took into account FERC's allocation of the entitlement power.

Nantahala had also sought to raise its intrastate rates in North Carolina. The Utilities Commission of North Carolina used a methodology, and assumption concerning available power, at odds with the analysis of FERC and concluded that Nantahala should calculate its costs for

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[10] We will, like plaintiffs, refer generally to Act 74 for convenience although plaintiffs are contesting only certain provisions of the Act.

state ratemaking as if it received 24.5% of the entitlement power.

The Supreme Court concluded that the state Utilities Commission could not engage in this inquiry. Based upon the "filed rate doctrine," the Commission had to accept the allocation of entitlement power determined by FERC. The Court stated:

> We acknowledge that this case does not present the typical application of the filed rate doctrine, in which a middleman faces a FERC-fixed wholesale rate charged by a power supplier. In that situation, for a state ratemaking agency to disregard a FERC-filed rate would clearly be inconsistent with the exclusive federal regulatory scheme over interstate wholesale power prices. The FERC-approved rate at which the middleman purchased power would not be fully recognized as a cost in the retail market, thereby forcing the middleman to sell power at less than its reasonable cost as determined by the federal agency.
>
> Here, in contrast, Nantahala both owns some of the facilities that produce the relevant electricity and sells that power to its retail customers, rather than to a distributor. But FERC's regulation of wholesale power rates nonetheless has a direct effect on Nantahala's costs of producing retail power. Nantahala has, through the NFA, contracted with TVA for the latter to control eight of Nantahala's eleven hydroelectric facilities, and that arrangement was approved by FERC in the course of rate proceedings over which FERC clearly had exclusive jurisdiction. FERC also examined the AA, a document filed in conjunction with the same proceeding, and concluded that the reasonable allocation of entitlement power was to give 77.5% of that power to Tapoco and 22.5% of that power to Nantahala.

> From Nantahala's point of view, then, it is in a situation quite similar to that of a purchaser of wholesale power at FERC-approved rates: Nantahala is entitled to include only a certain, FERC-specified amount of low-cost entitlement power among the sources of power from which it can draw in providing retail power. The fact that NCUC is setting retail rates does not give it license to ignore the limitations that FERC has placed upon Nantahala's available sources of low-cost power.

Id. at ——, 106 S.Ct. at 2358, 90 L.Ed.2d at 956.

The case at bar is easily distinguishable. Neither of the plaintiffs in this case is in the situation in which Nantahala found itself. Kentucky West is an interstate pipeline and makes no retail sales subject to PUC jurisdiction. Equitable, for the purposes of this action, is an intrastate retailer of natural gas which has available to it several sources of natural gas,[11] one of which is Kentucky West. No single entity, simultaneously serving as wholesaler and retailer, is subject to the potential of conflicting orders from federal and state agencies. There is accordingly no risk of "trapped costs" and the filed rate doctrine is inapplicable here.

That *Nantahala* cannot control this case is made clear by the following remarks from the opinion:

> [T]he North Carolina Supreme Court erred in relying on cases treating the reasonableness of purchasing from a particular source of, rather than paying a particular rate for, FERC-approved power. See *Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n*, 77 Pa Commw 268, 273-274, 465 A.2d 735, 737-738 (1983); *Kansas-Nebraska Natural Gas Co. v. State Corp. Comm'n*, 4 Kan App

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[11] Equitable does make certain sales which are subject to FERC jurisdiction. *See Equitable Gas Co.*, 26 FERC ¶ 61,325 (1984).

> 2d 674, 679-680, 610 P2d 121, 127 (1980). Without deciding this issue, we may assume that a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*.

Id. at ——, 106 S.Ct. at 2360, 90 L.Ed.2d at 958 (emphasis in original) (brackets added). This quotation generally describes the situation in the instant case. While we do not believe, as defendants urge upon us, that *Nantahala* thereby supports their position here, it certainly indicates that *Nantahala* does not control this case.

Plaintiffs also rely upon *Northern Natural Gas Co. v. State Corporation Comm'n*, 372 U.S. 84, 83 S.Ct. 646, 9 L.Ed.2d 601 (1963) and *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409, 106 S.Ct. 709, 88 L.Ed.2d 732 (1986). These cases, too, are distinguishable. Both of them dealt with a state regulation requiring an interstate pipeline to take gas from a common field on a *pro rata* basis from all those having an ownership interest in the field. The Court in *Transcontinental* relied upon *Northern Natural* to strike down the Mississippi regulation at issue there. It quoted the crucial language from *Northern Natural* as follows:

> The danger of interference with the federal regulatory scheme arises because these orders are unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce. In effect, these orders shift to the shoulders of interstate purchasers the burden of performing the complex task of balancing the output of thousands of natural gas wells within the State. . . . Moreover, any readjustment of purchasing patterns which such orders might require of

> purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States.

Id. at ——, 106 S.Ct. at 715, 88 L.Ed.2d at 742-43 (quoting *Northern Natural*, 372 U.S. at 92, 83 S.Ct. at 646, 9 L.Ed.2d at 601) (emphasis in *Northern Natural*).

The court then identified the bases under which pre-emption was justified in *Northern Natural*:

> Northern Natural's finding of pre-emption thus rests on two considerations. First, Congress had created a comprehensive regulatory scheme, and ratable-take orders fell within the limits of that scheme rather than within the category of regulatory questions reserved for the States. Second, in the absence of ratable-take requirements, purchasers would choose a different, and presumably less costly, purchasing pattern. By requiring pipelines to follow the more costly pattern, Kansas' order conflicted with the federal interest in protecting consumers by ensuring low prices.

Id. at ——, 106 S.Ct. at 715-14, 88 L.Ed.2d at 743.

Clearly, none of these considerations are present here. The state agencies in the above cases were requiring interstate pipelines to take volumes of gas from a state field and to place it in interstate commerce regardless of market forces and whether the pipeline would have purchased the gas as a business decision. Here, the PUC has focused on an intrastate retailer and its options from among several pipeline suppliers to satisfy the retailer's duty to Pennsylvania consumers. The scheme is within the category of regulatory questions reserved for the states and by imputing the purchase of lower cost gas to Equitable, admittedly by hindsight, is in accord with the federal interest in ensuring low prices for consumers.

A review of the Pennsylvania legislation under the supremacy clause standard of review indicates that it does not conflict with the NGA.

> The Natural Gas Act of 1938 granted FPC broad powers "to protect consumers against exploitation at the hands of natural gas companies." *FPC v Hope Natural Gas Co.* 320 US 591, 610, 88 L Ed 333, 349, 64 S Ct 281 [291] (1944). See *FPC v Transcontinental Gas Pipe Line Corp.* 365 US 1, 19, 5 L Ed 2d 377, 389, 81 S Ct. 435 [445] (1961); *Sunray Mid-Continental Oil Co. v FPC*, 364 US 137, 147, 4 L Ed 2d 1623, 1631, 80 S Ct 1392 [1398] (1960). To that end, Congress "meant to create a comprehensive and effective regulatory scheme," *Panhandle Eastern Pipe Line Co. v Public Service Comm'n*, 332 US 507, 520, 92 L Ed 128, 139, 68 S Ct 190 [197] (1947), of dual state and federal authority. Although federal jurisdiction was not to be exclusive, FPC regulation was to be broadly complementary to that reserved to the States, so that there would be no "gaps" for private interests to subvert the public welfare. This congressional blueprint has guided judicial interpretation of the broad language defining FPC jurisdiction, and "when a dispute arises over whether a given transaction is within the scope of federal or state regulatory authority, we are not inclined to approach the problem negatively, thus raising the possibility that a 'no man's land' will be created. Compare *Guss v Utah Labor Board*, 353 US 1 [1 L Ed 2d 601, 77 S Ct 598]. That is to say, in a borderline case where congressional authority is not explicit we must ask whether state authority can practicably regulate a given area and, if we find that it cannot, then we are impelled to decide that federal authority governs." *FPC v Transcontinental Gas Pipe Line Corp.*, supra, at 19-20, 5 L Ed 2d at 390 [81 S.Ct. at 445].

FPC v. *Louisiana Power & Light Co.*, 406 U.S. 621, 631, 92 S.Ct. 1827, 1833-34, 32 L.Ed.2d 369, 379-80 (1972). *See also Public Service Comm'n v. FERC*, 610 F.2d 439 (6th Cir.1979); *Clark v. Gulf Oil Corp.*, 570 F.2d 1138 (3d Cir.1977), *cert. denied sub nom., Philadelphia Gas Works v. Gulf Oil Corp.*, 435 U.S. 970, 98 S.Ct. 1611, 56 L.Ed.2d 62 (1978).

The NGA explicitly preserves state regulation of retail intrastate sales. Section 1(b), 15 U.S.C. § 717(b), provides as follows:

> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation and sale, but shall not apply to any other sale or transportation of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

In accord with this section, the Supreme Court has affirmed the principle that the NGA excluded federal jurisdiction over "direct consumer sales" within a state. *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n*, 332 U.S. 507, 519 n.15, 68 S.Ct. 190, 196 n.15, 92 L.E. 128, 139 n.15 (1947). And that is, of course, what the PUC was regulating when Equitable came before it in the section 1307(f) proceedings.

We can conclude from the foregoing that the state legislation does not fail the first three parts of the supremacy clause test. Congress did not expressly preempt state law on the subject. To the contrary, it expressly preserved areas of state concern for state control. *See Panhandle, supra.* Nor can preemption be inferred from the scheme of federal regulation. It does not comprehensively

govern the field of utility regulation. Rather, it was meant to be complementary to state control. Finally, the federal interest, at least at this time, cannot be said to be so dominant, given the historical right of the states to exercise police power over utilities, *see Arkansas Electric, supra,* to assume that the federal system must preclude enforcement of state law.

The only remaining factors are whether compliance with both federal and state regulations is a physical impossibility and whether state law stands as an obstacle to the full purposes and objectives of Congress.

Plaintiffs make no claim of physical impossibility but assert that Act 74 stands as an obstacle to the accomplishment and execution of certain provisions found in the NGPA. The following brief synopsis of what Congress intended to accomplish by enacting the NGPA will serve as a background for plaintiffs' claims.

> In 1978, Congress altered the regulatory scheme for natural gas by enacting the NGPA. In order to provide incentives for increased gas production, Congress partially deregulated the wellhead prices producers could charge for gas. The price of some categories of gas was completely exempted from all federal regulation within the year. Price controls were phased out gradually in other categories: the NGPA eliminated the Commission's ratemaking authority over "first sales" of natural gas immediately, 15 U.S.C. § 3431(a)(1) (1982), and substituted statutorily defined "maximum lawful prices" to act as ceilings during the interim period, *id.* §§ 3312-3319.
>
> Interstate pipelines, however, unlike producers, remained subject to regulation by the Commission, which, with one major exception, continues to scrutinize each pipeline's costs and to allow recovery in a pipeline's rates only of costs that are "prudently" incurred. In order to coordinate continued regulation

> of pipelines with deregulation of wellhead prices, Congress created an exception to pipeline regulation for gas acquisition costs, which, on average, account for about 90% of pipeline operating and maintenance costs. Section 601 of the NGPA replaced the "cost-of-service" analysis and provides that any amount paid for a wellhead purchase shall be deemed just and reasonable if the category of gas is deregulated or if the price does not exceed the maximum lawful price established by the NGPA. 15 U.S.C. § 3431(b) (1982). The Commission may not deny recovery of a pipeline's costs for purchasing gas if it meets this statutory definition of just and reasonable "except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds." *Id.* at § 3431(c)(2).

Office of Consumers' Counsel v. FERC, 783 F.2d 206, 213-14 (D.C.Cir.1986) (footnotes omitted).

Plaintiffs', citing *Public Service Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 103 S.Ct. 3024, 77 L.Ed. 2d 668 (1983), claim that Pennsylvania is denying the pass-through permitted by 15 U.S.C. § 3431(c)(2), section 601(c)(2) of the NGPA. They contend that Kentucky West is entitled to pass through increases of wellhead prices it has incurred from passage of NGPA. This position is correct as a general statement of the law but it cannot provide support for the further claim, in essence, that Equitable's purchase of Kentucky West gas cannot be reviewed by the PUC.

The PUC did not disallow any FERC approved rate or any rate FERC must accept as a consequence of the NGPA. It accepted all of those rates as they appeared in Equitable's suppliers' cost structures. It simply chose from among all of those competitors, the gas supply that, in its view, would have resulted in the lowest cost to Equitable. The NGPA does not guarantee a pipeline that

it will be able to sell its gas nor does it insulate from scrutiny a local distributor's decision to buy gas from among competing pipelines. This would be a different case if the PUC had decided to approve the purchase of Kentucky West gas but had refused Equitable a pass-through of a certain portion of the FERC approved rate. Here, purchases from Kentucky West had never been approved and there is no requirement in federal law requiring local regulatory approval of a distributor's purchasing decisions. For the same reasons, we must reject plaintiffs' argument based upon Title II of the NGPA, 15 U.S.C. §§ 3342-48.

Plaintiffs' reliance upon another provision of the NGPA must also be rejected. They point to section 602 (a), 15 U.S.C. § 3432(a), which permits a state "to establish or enforce any maximum lawful price for the first sale of natural gas in such State" and argue from it that Pennsylvania is illegally trying to regulate the first sale of natural gas in other states, contrary to the permissible limitations of the NGPA. These sales are purchases by Kentucky West in Kentucky and Virginia. This argument must fail because, again, Pennsylvania is merely regulating Equitable's purchases from competing suppliers and the NGPA does not guarantee Kentucky West sales of its gas to any purchaser.

We also find significant for the supremacy clause issue FERC's attitude toward state regulation of matters which have come before FERC for its approval. FERC has recognized that, while it has authority to approve rates for federal purposes, state regulatory agencies still have authority to determine if the utility's action was prudent in light of the agency's responsibilities to the state's consuming public. *See Southern Company Services, Inc.*, 26 FERC ¶ 61,360 (1984); *Pennsylvania Power and Light Co.*, 23 FERC ¶ 61,006 (1983); *Philadelphia Electric Co.*, 15 FERC ¶ 61,264 (1981). *Southern Company Services, Inc.*, illustrative. In that case, a settle-

ment contract came before FERC for approval. The City of Lafayette opposed it on the ground that it imposed certain unnecessary costs on one of the utilities. Rejecting the argument, FERC stated:

> Lafayette complains that GSU's contract with Southern Companies requires GSU to purchase a certain amount of power when GSU's own avoided costs of generation are greater than the cost of purchases from Southern Companies and precludes GSU from buying from other less costly sources. This preference issue is irrelevant to this case because the Commission is not empowered to disapprove or modify a power sales agreement on the grounds that the buyer may not be making the best possible deal. As we held in another case involving Southern Companies, the question of the prudence of a utility's power purchases is properly an issue in the buying utility's rate case where it seeks to pass the costs of its purchased power on to its ratepayers. If and when GSU make a rate filing reflecting its costs under these contracts, any interested party may intervene and challenge those costs.

Id., ¶ 61,360 at 61,795 (footnotes omitted).

In this regard, FERC's actions on a case-by-case basis are analogous to agency comments in federal regulations expressly setting forth an agency's attitude toward state regulation of the same area. In *Hillsborough County, supra*, the appellee, Automated Medical Laboratories, challenged Hillsborough County's ordinance dealing with blood donations as conflicting with the Food and Drug Administration's regulations in the same area. In rejecting the supremacy clause claim, the Supreme Court relied, in part, on the federal agency's statement accompanying the promulgation of the federal regulations in 1973 as follows: "[t]hese regulations are not intended to usurp the powers of State or local authorities to require plasmapheresis procedures in their localities." 471 U.S. at 714,

105 S.Ct. at 2375, 85 L.Ed.2d at 722. The Court found this to be the attitude of the FDA even after the federal regulations had been amended to broaden their coverage. Responding to a claim that the county ordinance would reduce the supply of plasma, the Court stated:

> Finally, the FDA possesses the authority to promulgate regulations pre-empting local legislation that imperils the supply of plasma and can do so with relative ease. See supra, at 713 [105 S.Ct. at 2375]. Moreover, the agency can be expected to monitor, on a continuing basis, the effects on the federal program of local requirements. Thus, *since the agency has not suggested that the county ordinances interfere with federal goals*, we are reluctant in the absence of strong evidence to find a threat to the federal goal of ensuring sufficient plasma.
>
> Our analysis would be somewhat different had Congress not delegated to the FDA the administration of the federal program. Congress, unlike an agency, normally does not follow, years after the enactment of federal legislation, the effects of external factors on the goals that the federal legislation sought to promote. Moreover, it is more difficult for Congress to make its intentions known—for example by amending a statute—than it is for an agency to amend its regulations or to otherwise indicate its position.
>
> In summary, given the finding of the District Court, the lack of any evidence in the record of a threat to the "adequacy" of the plasma supply, and the significance that we attach to the lack of a statement by the FDA, we conclude that the Hillsborough County requirements do not imperil the federal goal of ensuring sufficient plasma.

Id. at 720-22, 105 S.Ct. at 2379-80, 85 L.Ed.2d 726-27 (footnote omitted) (emphasis added). Similarly, based

upon FERC's attitude as expressed in previous orders, and its ability to monitor state action in this complex area, we are reluctant to find a supremacy clause violation.

We think that FERC's posture in this litigation also counsels against declaring the Pennsylvania legislation void on supremacy clause grounds. FERC was named a defendant in this suit but chose not to participate in any way even when it was noted by the court of appeals that "the final determination of the present case hinges in large part on questions involving the extent of FERC's jurisdiction under the NGA and NGPA, questions peculiarly within the Commission's competence . . ." *Kentucky West, supra*, 791 F.2d at 1118. The Court of Appeals also stated that FERC should be given an opportunity to respond. Yet in the face of plaintiffs' strenuously argued claim that the PUC was encroaching upon FERC's exclusive jurisdiction, FERC has simply filed a letter indicating only its intention to possibly participate on appeal, as it would normally do when not being sued for its own action. FERC can defer to state commissions when it is not inconsistent with national policy. *General Motors Corp. v. FERC*, 198 D.C.App. 206, 613 F.2d 939 (D.C.Cir.1979). Without the benefit of a brief from FERC we cannot be absolutely sure of our conclusion, but FERC's passive attitude in this litigation indicates that FERC does not perceive state regulation as hampering federal goals in the natural gas area, and that it has, in any event, deferred to state commissions in this area.

We conclude that Act 74 and the PUC order issued pursuant to its authority do not violate the supremacy clause, and we note our agreement with the rationale of the Pennsylvania Commonwealth Court on this issue. *See Pike County Light and Power Co. v. Pennsylvania Public Utility Comm'n*, 77 Pa.Cmwlth. 268, 465 A.2d 735 (1983).

B. *Act 74 Does Not Violate the Commerce Clause.*

1. *The Legislative History Does Not Show Enactment For Purposes of Economic Protectionism.*

Plaintiffs claim that Act 74 violates the commerce clause because the legislative history shows an intent to protect Pennsylvania's economy at the expense of other states. State legislation which discriminates in that way is unconstitutional. As stated by the Supreme Court in *City of Philadelphia v. New Jersey*, 437 U.S. 617, 623-24, 98 S.Ct. 2531, 2535, 57 L.Ed.2d 475, 481 (1978):

> The opinions of the Court through the years have reflected an alertness to the evils of "economic isolation" and protectionism, while at the same time recognizing that incidental burdens on interstate commerce may be unavoidable when a State legislates to safeguard the health and safety of its people. Thus, where simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected. See, e.g., *H.P. Hood & Sons, Inc. v Du Mond* [336 U.S. 525, 537-538, 69 S.Ct. 657, 665, 93 L.Ed. 865 (1949)] supra, *Toomer v Witsell*, 334 US 385, 403-406, 92 L.Ed. 1460, 68 S.Ct. 1156 [1165-67]; *Baldwin v G.A.F. Seelig, Inc.* [294 U.S. 511, 527, 55 S.Ct. 497, 502, 79 L.Ed. 1032 (1935)] supra; *Buck v. Kuykendall*, 267 US 307, 315-316, 69 L.Ed. 623, 45 S.Ct. 324 [325-26], 38 ALR 286. The clearest example of such legislation is a law that overtly blocks the flow of interstate commerce at a State's borders. Cf. *Welton v. Missouri*, 91 US [1 Otto] 275, 23 L.Ed. 347.

Plaintiffs find this intent to protect the Pennsylvania natural gas business in the words of State Representative William Lloyd, one of the sponsors of the law:

> On the question of shut-in gas, I know there are a lot of members in this chamber who have constitu-

> ents who would like to be selling gas to the utility companies and the utility companies will not buy it. If this bill passes, the utility companies are going to be under greater pressure to buy that Pennsylvania shut-in gas, which is going to be a good deal for Pennsylvania consumers as well as a good deal for the Pennsylvania oil and gas fields.

Pa.Legis.J. House at 1975 (Dec. 5, 1983). They also point to another sponsor, Representative Charles Laughlin who said:

> I think the People's Gas Company . . . is an outstanding example of drilling for gas in the State of Pennsylvania, where approximately 30 percent of their supply is delivered from wells here in Pennsylvania, not supplied by long-distance pipeline, not supplied on "take-or-pay" contracts at accelerated prices.
>
> Let us look also at the possibility that this bill creates and the incentive it creates for those companies to drill in the State of Pennsylvania.
>
> [I] believe that Pennsylvania, as well as a lot of companies such as People's that have drilled here, has a considerable amount of gas underground that can be found, and it can be found at a much lower price than what they are talking about in the Gulf of Mexico and the transportation costs that are added to it . . . and, this legislation reaches out to [interstate] pipelines. It reaches out to the transmission companies.

Pa.Legis.J. House at 1973 (Dec. 5, 1983).

We cannot accept these remarks as probative of an unconstitutional intent. Remarks of an individual legislator are not binding as to legislative intent, *Hoffman v. Pennsylvania Crime Victims' Compensation Board*, 46 Pa.Cmwlth. 54, 57 n. 2, 405 A.2d 1110, 1112 n. 2

(1979).[12] Additionally, these remarks were not joined in by the other co-sponsors or other members of the Pennsylvania General Assembly. Moreover, the history is inconsistent.[13] Elsewhere, Representative Kukovich stated that:

> Basically, when we vote for this legislation, we are doing three things: We are abolishing an automatic pass-on; we are forcing natural gas companies to provide more disclosure to the PUC; and generally the third thing is to try to set up a system in rate filings where we are going to put pressure on our 43 gas utilities in this State to buy the least costly gas. We are going to force them through HB 132 to put pressure on down the line to get the cheapest gas possible. That is the single most important thing we can do as legislators in the State of Pennsylvania to bring some reasonable fiscal practices to the purchase of natural gas and the cost of gas utility bills in this State. I think it is imperative that we vote for this legislation and do one of the most important things we can for the utility consumer in this State in this session of the General Assembly.

Id. at 1971.

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[12] We believe we should follow statutory construction rules of the state in construing a state statute even though a federal question is involved. *See Exxon Corp. v. Eagerton*, 462 U.S. 176, 180, n. 3, 103 S.Ct. 2296, 2300 n. 3, 76 L.Ed.2d 497, 504 n. 3 (1983). In any event, our analysis would be the same if we followed federal statutory construction rules. *See Chrysler Corp. v. Brown*, 441 U.S. 281, 99 S.Ct. 1705, 60 L.Ed.2d 208 (1979).

[13] Thus, this case is distinguishable from *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984), relied upon by plaintiffs, which, in any event, did not rely upon remarks of an individual legislator but upon a state senate report on the legislation at issue.

The thrust of these comments is consumer protection. And Representative Robert Freeman stated that Act 74 would require "gas companies to buy the cheapest possible gas." *Id.* at 1973. He made no reference to helping Pennsylvania producers. The comments of the latter two legislators relate to protecting the Pennsylvania consumer of natural gas, a permissible state interest.

2. *Act 74 Does Not Unconstitutionally Burden Interstate Commerce.*

Since we have concluded that Act 74 pursues a legitimate state purpose, we may evaluate it under the following commerce clause standard.

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. . . . If a legitimate local purpose is found, then the question becomes one of degree. And to the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

City of Philadelphia, supra, 437 U.S. at 624, 98 S.Ct. at 2535, 57 L.Ed.2d at 482 (quoting *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 844, 25 L.Ed.2d 174, 178 (1970)).

Plaintiffs presented the following evidence concerning Act 74's effect upon interstate commerce. Joseph Ramsey, vice-president of rates and strategic planning for Tennessee, testified that Tennessee services 104 customers in 21 states. When one customer, as Equitable has done here, reduces its take from Tennessee's system, certain problems could occur. First, while a reduction in take

by one customer, even of a large magnitude, can be handled, if the customer would want to increase its purchases later, insufficient notice could result in temporary operational problems affecting other customers.

There are also financial implications. Tennessee has a large exposure for take or pay costs. If Equitable reduces its purchases from Tennessee, this will increase the latter's take or pay costs which may have to be charged to Tennessee's other customers. Similarly, fixed costs which could be attributed to Equitable, would have to be spread over a smaller customer base, causing these customer costs to go up. Plaintiffs also claim that the PUC order will make it more difficult to acquire new gas reserves. In all, Tennessee's customers in 21 states will be affected. Witnesses spoke of similar problems for Kentucky West and Texas Eastern. Finally, local producers in eastern Kentucky and western Virginia may have to shut-in their wells. This is because a smaller volume of gas going to Equitable will cause Kentucky West to reduce its purchases from local producers.

In disagreeing with plaintiffs' argument, defendants assert that plaintiffs' evidence is speculative and inconclusive. Additionally, the impact on interstate commerce is negligible, and acceptable in any event, given the legitimate state goal served by Act 74. Further, the Pennsylvania law is actually consistent with federal policy on interstate gas sales.

We agree with defendants' position. First, testimony relied upon by plaintiffs is too speculative to support the claim that the PUC Order will unconstitutionally affect interstate commerce. Mr. Ramsey's testimony was conditional. He spoke of what may happen rather than of what will happen. We think the testimony of the other witnesses essentially suffers from the same defect despite being put in more positive terms. Second, we think the predictions of the dire consequences which would befall

interstate comerce in natural gas are overstated in light of FERC's consideration of the same problems in Order 380, 27 FERC ¶ 61,318, 49 Fed.Reg. 22, 778 (1984).[14]

In Order 380, FERC eliminated the recovery of purchased gas costs by a pipeline for gas not taken by the buyer. It did so despite comments on the Order which were similar to those raised by plaintiffs in this action. Thus, it was claimed before FERC that elimination of the purchased gas costs would leave pipelines with no way to recover contractual obligations for take-or-pay costs owed to its suppliers. But FERC recognized that take-or-pay levels can be renegotiated and Tennessee has acknowledged in this action that it has been, in fact, attempting to renegotiate its take-or-pay commitments.

Additionally, plaintiffs' claim of curtailment problems if a customer decreases, and then later increases, its demand for gas does not appear to be likely since the customer's new pipeline may well increase its supply of gas to meet the new demand placed upon it. This would reduce the likelihood of shifts back to the old pipeline. In any event, FERC has procedures whereby gas can be shifted from one pipeline to another to prevent curtail-

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[14] Plaintiffs have also asserted, in advancing their claim of economic detriment to Equitable, that the disallowance of the $14.3 million in purchased gas costs has reduced Equitable's return on its property to zero in violation of its due process rights. *See Bluefield Waterworks & Improvement Co. v. Public Service Comm'n*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923). The PUC disputes that the calculation must be based on Equitable's property. Rather, since Equitable is a division of Equitable Resources, Inc., the latter company's assets provide the basis for determining return on equity. We need not decide this issue because we accept the PUC's further argument that a regulated company cannot make a due process claim when the prudence of its expenditures is at issue. *See Butler Township Water Comm'n v. Pennsylvania Public Utility Comm'n*, 81 Pa.Cmwlth. 40, 473 A.2d 219 (1984) (en banc). *See also generally D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Comm'n*, 151 D.C.App. 223, 466 F.2d 394, 418-23 (D.C.Cir.), *cert. denied*, 409 U.S. 1086, 93 S.Ct. 688, 34 L.Ed.2d 673 (1972).

ment. *See generally* FERC Order 380, 26 FERC ¶ 30,571 at 30,968 and note 42. And, in connection with Equitable's argument that certain portions of its territory can only be reached by Tennessee's pipeline, any attemped abandonment by Tennessee would be subject to FERC approval.

FERC Order 380 provides us with a significant and in-depth statement of FERC's current attitude toward how the national market for natural gas should be regulated and supports our conclusion here that Act 74 should not be struck down on the basis of the present record.[15] The history of natural gas regulation in this country shows that the problem is a complex one and that the solutions of the past were never satisfactory for long. *See Transcontinental Gas Pipe Line Corp., supra; Public Service Commission v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 103 S.Ct. 3024, 77 L.Ed.2d 668 (1983). The most recent Congressional attempt at providing reasonably priced and adequate supplies of gas to consumers is the NGPA, which attempts to introduce traditional market-type incentives to the natural gas area.

In accord with the NGPA, Order 380 is one attempt by FERC to carry the notion of price sensitivity into contractural arrangements between producers, pipelines and distributors—arrangements which traditionally permitted the pass-through of purchased gas costs by pipelines. In disallowing an automatic pass-through, FERC hoped to create pressure throughout the entire system for distribution of gas based on market forces. In so doing, FERC noted that some pipelines and distributors have attempted "to pursue a least-cost gas purchasing policy." Significantly, it also noted that "some states have mandated

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[15] Order 380 was affirmed in material part in *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied sub nom Transwestern Pipeline Co. v. FERC*, —— U.S. ——, 106 S.Ct. 1968, 90 L.Ed.2d 653 (1986).

such an approach." 26 FERC ¶ 30,571 at 30,964. And, FERC in previous actions had encouraged utilities to adopt such a policy. Thus, it is significant that FERC has not disapproved of state action in this regard or questioned the jurisdiction of a state to pursue such a goal.

Under these circumstances, Act 74 dovetails nicely with the current federal attitude and accomplishes at the intrastate retail level what FERC is attempting to do at the interstate level. The PUC's action may have some affect upon interstate commerce but we conclude that it is only incidental and that the legitimate local purpose clearly outweighs any burden upon interstate commerce. Indeed, Act 74 serves the federal interest as well. Moreover, this state interest cannot be promoted with a lesser impact on interstate commerce since, as noted previously, FERC has refused to take into account in its own proceedings the interests asserted by Pennsylvania. *Massachusetts v. United States*, 729 F.2d 886 (1st Cir. 1984), cited by the Amicus in support of its claim that the PUC should avail itself of FERC proceedings to protect Pennsylvania consumers, is distinguishable because there the challenged practice was subject to the regulatory jurisdiction of FERC, not Massachusetts. And FERC was perfectly willing to adjudicate Massachusetts's claim once the state complied with proper statutory procedural requirements.

The PUC's action does not simplistically favor in-state gas producers over producers from other states. Hence, the situation is different from *Transcontinental*, *supra*, or *Northern Natural*, *supra*, relied upon by plaintiffs. Rather, the PUC has operated evenhandedly to effectuate a legitimate local interest, based upon a statute which requires that a distributor pursue a least cost fuel procurement policy regardless of where the gas is obtained. Therefore, we believe that defendants may justifiably rely

upon *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 98 S.Ct. 2207, 57 L.Ed.2d 91 (1978), to support their contention that interstate commerce has not been unconstitutionally affected or burdened here. In *Exxon Corp.*, Maryland passed a law prohibiting a producer or refiner of petroleum products from operating a retail service station within the state. Upholding the law against a commerce clause challenge, the Supreme Court stated:

> As the record shows, there are several major interstate marketers of petroleum that own and operate their own retail gasoline stations. These interstate dealers, who compete directly with the Maryland independent dealers, are not affected by the Act because they do not refine or produce gasoline. In fact, the Act creates no barriers whatsoever against interstate independent dealers; it does not prohibit the flow of interstate goods, place added costs upon them, or distinguish between in-state and out-of-state companies in the retail market. The absence of any of these factors fully distinguishes this case from those in which a State has been found to have discriminated against interstate commerce. See, e.g., *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 53 L.Ed.2d 383, 97 S. Ct. 2434; *Dean Milk Co. v. Madison*, 340 U.S. 349, 95 L.Ed. 329, 71 S.Ct. 295. For instance, the Court in Hunt noted that the challenged state statute raised the cost of doing business for out-of-state dealers, and in various other ways, favored the in-state dealer in the local market. 432 U.S., at 351-352, 53 L.Ed.2d 383, 97 S.Ct. 2434. No comparable claim can be made here. While the refiners will no longer enjoy their same status in the Maryland market, in-state independent dealers will have no competitive advantage over out-of-state dealers. The fact that the burden of a state regulation falls on some interstate

> companies does not, by itself, establish a claim of discrimination against interstate commerce.

Id. 437 U.S. at 125-26, 98 S.Ct. at 2214, 57 L.Ed.2d at 100 (footnotes omitted).

In the instant case, the statute merely requires the utility to pursue a least cost fuel procurement policy. It requires no purchases from in-state producers except to the extent that the local producer is selling the least cost fuel. Because the statute does not categorize in terms of local producers and out-of-state producers, it does not violate the commerce clause.

We therefore conclude it is irrelevant that the PUC order penalized Equitable for purchasing from Kentucky West rather than from Pennsylvania producers. The disallowance of purchases from Kentucky West was not accomplished to favor these producers. The order also shifted purchases from one interstate pipeline, Tennessee, to another interstate pipeline, Texas Eastern. Moreover, the PUC order would also have benefitted local production in West Virginia. We do not believe that the mere showing that in one particular proceeding the PUC believed some purchases should have been made from in-state suppliers is sufficient to establish the improper aim of the law. The PUC's order did not unconstitutionally affect interstate commerce.

We also conclude that the "Balkanization" argument is too speculative to accept at this time. Plaintiffs speak only of the inevitability of other states passing similar laws, but they have not been able to point to any other state regulatory proceeding which has resulted in an actual conflict with the PUC order. They do point to West Virginia proceedings in which they claim the West Virginia Public Service Commission concluded that Equitable had pursued a least cost fuel procurement policy. However, the circumstances were not shown to be the same as in the Pennsylvania case. Additionally, while it is

true that the West Virginia Commission concluded that Equitable could not find dependable, lower-priced supplies of natural gas, in accordance with the requirements of West Virginia law, other than those purchased, it did require Equitable to make a more diligent effort in the future. (Plaintiffs' Exhibit 8). We are reluctant to conclude at this time that "Balkanization" requires us to strike down Act 74.[16]

Since the passage of the NGPA, the interstate marketing of natural gas has obviously undergone great change. If the issuance of conflicting orders by state regulatory agencies eventually becomes a problem in the interstate market, FERC will undoubtedly intervene to protect that market. We think that plaintiffs' claim of injury here is in a similar posture to the one raised in *Federal Power Commission v. Texaco, Inc.*, 417 U.S. 380, 94 S.Ct. 2315, 41 L.Ed.2d 141 (1974). Parenthetically, that case also answers plaintiffs' claim that Act 74 unfairly subjects Equitable to hindsight review of its gas purchases. In *Texaco*, pipelines and large producers challenged a Federal Power Commission (FPC) order which indirectly regulated the rates charged by small producers. This occurred in FPC reviews of the costs of gas purchases by large producers and pipelines.[17] The order did not permit refunds from the small producers if their rates were later found to be unreasonable. Commenting on the general validity of such a scheme, the Supreme Court stated:

> This leads to the contention of the pipelines and the large producers that the scheme of indirect regulation envisioned by Order No. 428 unfairly subjects

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[16] Plaintiffs also argue that FERC found Equitable's purchasing practices just and reasonable in its sales to Revere Gas Co. but it has already been established that FERC does not concern itself with whether any contractual arrangement represents the best buy for any party.

[17] The Federal Power Commission was FERC's predecessor.

> them to the risk of later determination that their gas costs are unjust and unreasonable and to the obligation to make refunds which they cannot in turn recover from the small producers whose rates have been found too high. But those whose rates are regulated characteristically bear the burden and the risk of justifying their rates and their costs. Rate regulation unavoidably limits profits as well as income. "The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid." [citation omitted].

Id. 417 U.S. at 391, 94 S.Ct. at 2323, 41 L.Ed.2d at 153 (brackets added) (footnote omitted).

The Court went on to note that regulation of producer prices was still experimental and that the Commission was going to keep the procedure under close review. Similarly, here, the PUC review of purchased gas costs is not improper simply because it is retroactive. Also, as in *Texaco*, only time and experience can tell whether Pennsylvania's law will have the effects claimed by plaintiffs, and in that event we anticipate that FERC will protect its own jurisdiction.

C. *Act 74 Does Not Violate The Equal Protection Clause.*

Plaintiffs claim that Act 74 violates the fourteenth amendment guarantee of equal protection because section 1318(a) makes the Act applicable to "utilities with gross intrastate operating revenues in excess of $40,000,000." They complain that neither the Act nor its legislative history explain the basis for the distinction and that testimony from a PUC representative is a *post hoc* rationalization.[18] They also argue that Equitable is

[18] The remarks of Senator William Moore are somewhat contrary to this position although they do not refer specifically to the $40 million threshhold. *See* Pa.Leg.J. Senate at 2092 (May 2, 1984).

unique among utilities with a certain level of operating revenue and that this uniqueness bars its grouping with utilities identified by section 1318(a). They point to its regulation by three state commissions, FERC, and the affect of its purchases upon the sales of three pipelines and independent gas producers.

Defendants argue that the classification is a valid one based upon administrative efficiency. Ten utilities meet the threshold revenue requirement and they are accountable for 96% of the operating revenue of all the natural gas companies in Pennsylvania and 97 to 98% of the customers. Limiting the application of Act 74 to the ten largest utilities allows meaningful review of the majority of the purchased gas costs decisions.

In passing upon the equal protection claim we must bear in mind that "the judiciary may not sit as a super-legislature to judge the wisdom or desirability of legislative policy determinations made in areas that neither affect fundamental rights nor proceed along suspect lines. . . ." *City of New Orleans v. Dukes*, 427 U.S. 297, 303, 96 S.Ct. 2513, 2517, 49 L.Ed.2d 511, 517 (1976) (per curiam). Accordingly, we will test plaintiffs' claim "under the lenient standard of rationality that [the Supreme] Court has traditionally applied in considering equal protection challenges to regulation of economic and commercial matters." *Exxon Corporation v. Eagerton*, 462 U.S. 176, 195-96, 103 S.Ct. 2296, 2308, 76 L.Ed.2d 497, 513 (1983). "Under that standard a statute will be sustained if the legislature could have reasonably concluded that the challenged classification would promote a legitimate state purpose." *Id.* at 196, 103 S.Ct. at 2308, 76 L.Ed.2d at 513. Further,

> [T]he Supreme Court has stated that legislative classifications will be upheld under rational relationship scrutiny "if any state of facts reasonably can be conceived that will sustain" them. *Lindsley v.*

> *Natural Carbonic Gas Co.*, 220 U.S. [61] at 78, 31 S.Ct. [337] at 340 [55 L.Ed. 369 (1911)]. "Where . . . there are plausible reasons for [the legislature's] action, our inquiry is at an end. It is, of course, 'constitutionally irrelevant whether this reasoning in fact underlay the legislation,' because this Court has never insisted that a legislative body articulate its reasons for enacting a statute." *U.S. Railroad Retirement Board v. Fritz*, 449 U.S. 166, 179, 101 S.Ct. 453, 461, 66 L.Ed.2d 368 (1980) (citations omitted).

Price v. Cohen, 715 F.2d 87, 94 (3d Cir.1983) (brackets added) (footnote omitted), *cert denied*, 465 U.S. 1032, 104 S.Ct. 1300, 79 L.Ed.2d 700 (1984).

Nevertheless, the Third Circuit Court of Appeals has noted that:

> While deferential, the rational relationship test is not "toothless," *U.S. Railroad Retirement Bd. v. Fritz*, 449 U.S. [166] at 184, 101 S.Ct. [453] at 464 [66 L.Ed.2d 368 (1980)]. (Brennan, J., dissenting). As Justice Powell warned in *Schweiker v. Wilson*, "the Court should receive with some skepticism *post hoc* hypotheses about legislative purpose, unsupported by legislative history. When no indication of legislative purpose appears other than the current position of the [government], the court should require that the classification bear a 'fair and substantial relation' to the asserted purpose." *Schweiker v. Wilson*, 450 U.S. [221] at 244-245, 101 S.Ct. [1074] at 1087-88 [67 L.Ed.2d 186 (1981)] (Powell, J., dissenting); *Delaware River Basin Commission v. Bucks Co.*, 641 F.2d 1087, 1096 (3d Cir. 1981).

Id. at 94 (footnote omitted) (brackets in original). But, "[e]ven this more skeptical approach . . . involves an only 'marginally more demanding scrutiny.' *Schweiker*

v. Wilson, 450 U.S. at 245, 101 S.Ct. at 1088 (Powell, J., dissenting)." *Id.* at 95 (brackets added).

Based upon the foregoing standard, we conclude that Act 74 does not violate the equal protection clause. Plaintiffs claim that Equitable's "uniqueness" entitles it to prevail on this issue.[19] But other than asserting that uniqueness and relying upon factors that bear upon its other constitutional claims, plaintiffs do not assert why equal protection has been violated. Further, the absence of a reason for the classification in the statute itself, or in the legislative history, is irrelevant because, as noted above, the Supreme Court has never required a legislature to articulate its reasons for enacting a statute. The absence of such reasons in the legislative history requires a court to determine if the classification bears a "fair and substantial" relation to the subsequently asserted purpose. But this necessitates only a marginally more demanding scrutiny under the rational relationship test. That scrutiny has been easily met in this action. The classification is clearly and directly related to the goal of administrative efficiency asserted by the PUC representative. His testimony was proper to substantiate this purpose and sustains the defendants' position here. *See Delaware River Basin Commission v. Bucks County Water & Sewer Authority*, 641 F.2d 1087, 1099 n. 25 (3d Cir.1981).

We will issue an appropriate order.

ORDER AND JUDGMENT

AND NOW, this 23rd day of December, 1986, it is ordered that:

1. Judgment is hereby entered in favor of defendants and against plaintiffs on all of plaintiffs'

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[19] "Uniqueness" is based upon the fact that Equitable is regulated by three state commissions as well as the FERC, and has contractual ties to interstate pipelines and independent producers.

claims except the claim of interference with the right to counsel.

2. Defendant, Attorney General's, motion for sanctions and his motion to exclude an issue are denied.

3. Defendants' motion in limine is dismissed as moot.

4. Defendant, PUC's, motion to amend its answer is denied.

5. The Clerk of Court shall close this file.

APPENDIX C

UNITED STATES COURT OF APPEALS
THIRD CIRCUIT

No. 85-5779

KENTUCKY WEST VIRGINIA GAS COMPANY, Equitable Gas Company, a division of Equitable Resources, Inc., American Gas Association (Amicus Curiae),

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, Taliaferro, Linda C., Commissioner, Fischl, Frank, Commissioner, Shane, Bill, Commissioner, Federal Energy Regulatory Commission, Attorney General (Intervenor), Barasch, David M., Consumer Advocate (Intervenor),

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Appeal of Kentucky West Virginia Gas Company and Equitable Gas Company, a division of Equitable Resources, Inc.

Argued April 15, 1986

Decided June 2, 1986

William A. Mogel (argued), William R. Mapes, Jr., Randall C. Smith, Ross, Marsh & Foster, Washington,

D.C., for appellants Kentucky West Virginia Gas Co., et al.; Charles E. Thomas, Jr., Carroll F. Purdy, Thomas & Thomas, Harrisburg, Pa., of counsel.

Alphonso Arnold, Jr. (argued), Asst. Counsel, John F. Povilaitis, Deputy Chief Counsel, Daniel P. Delaney, Deputy Chief Counsel, Charles F. Hoffman, Chief Counsel, Pennsylvania Public Utility Com'n, Harrisburg, Pa., for appellee Pennsylvania Public Utility Com'n, et al.

William H. Satterfield, General Counsel, Jerome M. Feit, Solicitor, Joanne Leveque, Atty., F.E.R.C., Washington, D.C., for appellee F.E.R.C.

Leroy S. Zimmerman, Atty. Gen., Eugene F. Waye, Deputy Atty. Gen., Michael A. Finio (argued), Deputy Atty. Gen., Office of Atty. Gen., Harrisburg, Pa., for intervenor-appellee Atty. Gen. of Pennsylvania.

David M. Barasch, Consumer Advocate, H. Kay Dailey (argued), Asst. Consumer Advocate, Office of Consumer Advocate, Harrisburg, Pa., for intervenor-appellee Consumer Advocate of Pennsylvania.

David J. Muchow, Eric N. Wise, American Gas Ass'n, Arlington, Va., for amicus curiae American Gas Ass'n.

Before SEITZ, HIGGINBOTHAM, and BECKER, Circuit Judges.

OPINION OF THE COURT

SEITZ, Circuit Judge.

The Kentucky West Virginia Gas Company ("Kentucky West") and the Equitable Gas Company ("Equitable Gas") appeal from a final order of the district court dismissing their complaint for declaratory and injunctive relief, 620 F.Supp. 1458. The district court held that *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943), and *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971), mandated that it abstain from reaching the merits of the companies'

complaint. Subject matter jurisdiction in the district court was premised on 28 U.S.C. §§ 1331 and 1337.[1] This court has jurisdiction by virtue of 28 U.S.C. § 1291.

I.

A. *The Pennsylvania Statutory Framework*

In 1984, Pennsylvania modified the procedures by which natural gas distribution companies establish rates for the retail sale of gas to Pennsylvania consumers. *See* Act of May 31, 1984, Act No. 1984-74 ("Act 74"), *codified at* 66 Pa.Cons.Stat.Ann. §§ 1307(f), 1317-1318 (Purdon Supp.1985). Under the Act 74 framework, "[n]atural gas distributors with gross intrastate annual operating revenues in excess of $40,000,000 may file tariffs reflecting increases or decreases in their natural gas costs . . ., but no such natural gas utility shall voluntary file more than one such tariff in a 12-month period." *Id.* § 1307(f)(1).

Before a proposed tariff can become effective, however, the PUC must conduct an investigation to determine whether the proposed rates are "just and reasonable." *See id.* §§ 1307(f)(2), 1318. And "[n]o rates for a natural gas distribution utility shall be deemed just and reasonable *unless* the commission finds that the utility is pursuing a *least cost fuel procurement policy*, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers." *Id.* § 1318(a) (emphasis added). When making this determination, the PUC must make specific findings that:

> (1) The utility has fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission.

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[1] The Pennsylvania Public Utility Commission ("PUC") argued below that the Johnson Act, 28 U.S.C. § 1342, prohibited the district court from exercising jurisdiction over plaintiffs' complaint. The district court rejected this argument, however, and the PUC has not pursued it on appeal.

(2) The utility has taken all prudent steps necessary to negotiate favorable gas supply contracts and to relieve the utility from terms in existing contracts with gas suppliers which are or may be adverse to the interests of the utility's ratepayers.

(3) The utility has taken all prudent steps necessary to obtain lower cost gas supplies on both short-term and long-term bases both within and outside the [state of Pennsylvania]. . . .

(4) The utility has not withheld from the market . . . any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

Id. § 1318(a)(1)-(4). In addition, if the utility purchases all or part of its natural gas from an *affiliated interest*, the PUC must make specific findings with regard to the justness and reasonableness of such purchases, including findings:

(1) That the utility has fully and vigorously attempted to obtain less costly gas supplies on both short-term and long-term bases from nonaffiliated interests.

(2) That each contract for the purchase of gas from its affiliated interest is consistent with a least cost fuel procurement policy.

(3) That neither the utility nor its affiliated interest has withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

Id. § 1318(b)(1)-(3).

Finally, for purposes of an Act 74 determination, the fact that the Federal Energy Regulatory Commission ("FERC") has approved a contract or rate for *interstate* purposes is "not, in and of itself, . . . adequate to satisfy the utility's burden of proof that gas prices and

volumes associated with such contract or rate are just and reasonable for purposes of this section."
Id. § 1318(d).

B. *The Equitable Gas Rate Proceeding*

Plaintiff Equitable Gas, a division of Equitable Resources, Inc. ("Equitable Inc"), is a Pennsylvania corporation engaged in the production, transportation, storage, distribution, and sale of natural gas. The company serves approximately 240,000 retail customers in the greater-Pittsburgh area. It obtains approximately eighty percent of the gas necessary to serve these customers from three interstate pipeline suppliers pursuant to tariffs approved by FERC.[2] The company obtains the remainder of its gas from one of two sources: its own wells in West Virginia and Pennsylvania, or independent producers under supply agreements either approved by FERC or exempted from such regulation by 15 U.S.C. § 3431.

In March 1985, Equitable Gas initiated an Act 74 proceeding before the PUC in which the company sought to modify its retail sales tariff to reflect changes in its purchased-gas costs. In particular, the company sought to recover costs passed on to it by its interstate pipeline suppliers from July 1983 through December 1984, and for anticipated increases in the cost of purchased gas for the period from September 1985 through August 1986.

In response to this request, the PUC initiated an investigation of the justness and reasonableness of the rates proposed by Equitable Gas. This investigation culminated in an order (the "PUC Order") denying the relief sought by the company. First, as to the period

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[2] One of these suppliers is plaintiff Kentucky West, a wholly-owned subsidiary of Equitable Inc., which sells approximately seventy percent of its gas to Equitable Gas.

from July 1983 through December 1984, the PUC concluded that Equitable Gas had *not* pursued a least cost fuel procurement policy. Specifically, the Commission found that the company should have taken more gas from its own wells and/or independent producers instead of gas it purchased from Kentucky West, which would have resulted in cost savings of approximately $14.3 million. As a result, the PUC refused the company's request to pass on these costs to its Pennsylvania ratepayers.

Second, with respect to the future period from September 1985 through August 1986, the PUC found that Equitable Gas should reduce its purchases from the Tennessee Gas Pipeline Company (its most expensive interstate supplier) and replace those amounts with increased purchases from the Texas Eastern Transmission Corporation (its least expensive interstate supplier). The PUC projected that such action by Equitable Gas would result in cost savings of approximately $3.0 million for Pennsylvania ratepayers.

Third, the PUC rejected the company's attempt to recover projected minimum-bill liability to Kentucky West for gas not actually taken under its contract with the pipeline, resulting in further cost savings of approximately $0.7 million.

Finally, the PUC ordered Equitable Gas, "in its next Section 1307(f) filing [to] certify that it has employed separate, independent legal counsel, with access to a technical staff separate and independent from its affiliated pipeline supplier, Kentucky West . . ., to represent it before [FERC]."

Equitable Gas has pursued two avenues of relief from the PUC's order. Initially, it filed a Petition for Review in the Commonwealth Court of Pennsylvania pursuant to 42 Pa. Cons. Stat. Ann. § 763(a)(1) (Purdon 1981)

and Pa.R.App.P. 1512(a)(1) (Purdon 1985).[3] Shortly thereafter, Kentucky West and Equitable Gas filed suit against the PUC in the district court, seeking declaratory and injunctive relief. The complaint in the latter action challenges portions of both the PUC Order and Act 74, alleging, *inter alia*, that they are either preempted by the Natural Gas Act ("NGA") and the Natural Gas Policy Act ("NGPA"), or that they violate the commerce and equal protection clauses.

After a hearing on the companies' motion for entry of a preliminary injunction, the district court dismissed the action. The court concluded that although Kentucky West and Equitable Gas had properly invoked its jurisdiction, abstention was required by *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943). Alternatively, the court concluded that abstention was independently required by *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971). This appeal followed.

II.

"Abstention is a judicially created doctrine under which a federal court will decline to exercise its jurisdiction so that a state court or state agency will have the opportunity to decide the matters at issue." *Heritage Farms v. Solebury Township*, 671 F.2d 743, 746 (3d Cir.), *cert. denied*, 456 U.S. 990, 102 S.Ct. 2270, 73 L.Ed.2d 1285 (1982). The doctrine, "born out of a concern for the maintenance of our federal system," *id.*, represents an extraordinary and narrow exception to the "virtually unflagging obligation of the federal courts to exercise the jurisdiction given them." *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 817, 96 S.Ct. 1236, 1246, 47 L.Ed.2d 483 (1976).

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[3] Although the status of this appeal is somewhat unclear, Kentucky West and Equitable Gas have indicated that they will not pursue that action if the district court addresses the merits of their complaint.

"Abdication of the obligation to decide cases can be justified under this doctrine only in the exceptional circumstances where the order to the parties to repair to the State court would clearly serve an important countervailing interest." *County of Allegheny v. Frank Mashuda Co.*, 360 U.S. 185, 188-89, 79 S.Ct. 1060, 1063, 3 L.Ed.2d 1163 (1959). Consistent with the proposition that "[a]bstention from the exercise of federal jurisdiction is the exception, not the rule," *Colorado River*, 424 U.S. at 813, 96 S.Ct. at 1244, the Supreme Court has confined the circumstances appropriate for abstention to three general categories of cases, two of which the district court relied upon here.

A. *Burford Abstention*

Generally speaking, abstention under the doctrine of *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943), is appropriate in two situations: first, "where there have been presented difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar"; and second, where "the exercise of federal review of the question in a case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern." *Colorado River*, 424 U.S. at 814, 96 S.Ct. at 1245.

In the present case, the district court found these considerations compelling in light of "the great interest the states have in regulating retail utility rates within their boundaries." *Kentucky W. Va. Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 620 F.Supp. 1458 (M.D.Pa.1985), *citing Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983). Kentucky West and Equitable Gas challenge this conclusion. The crux of their argument is that *Burford* abstention is almost never appropriate where a fed-

eral plaintiff asserts a preemption claim. We review district court decisions to abstain (under *Burford or Younger, see infra* at 1116-17) by an abuse of discretion standard. *Heritage Farms*, 671 F.2d at 748.[4]

By and large, the Courts of Appeal that have addressed this question have been sympathetic to the argument advanced by Kentucky West and Equitable Gas. *See New Orleans Pub. Serv., Inc. v. City of New Orleans*, 782 F.2d 1236, 1243 (5th Cir.1986); *Middle S. Energy, Inc. v. Arkansas Pub. Serv. Comm'n*, 772 F.2d 404, 417 (8th Cir.1985), *cert. denied*, — U.S. —, 106 S.Ct. 884, 88 L.Ed.2d 919 (1986); *Baggett v. Dep't of Professional Regulation*, 717 F.2d 521, 524 (11th Cir. 1983); *International Bhd. of Elec. Workers, Local Union No. 1245 v. Public Serv. Comm'n*, 614 F.2d 206, 212 n. 1 (9th Cir.1980).[5] *But see Aluminum Co. of America v. Utilities Comm'n*, 713 F.2d 1024, 1030 (4th Cir.1983) (rejecting claim that abstention is never appropriate where preemption is at issue, and holding that, at least where detailed factfinding was required to evaluate plaintiffs' claim of preemption, district court did not abuse its discretion in abstaining under *Buford*), *cert. denied*, 465 U.S. 1052, 104 S.Ct. 1326, 79 L.Ed.2d 722 (1984).

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[4] In addition, "[b]ecause a dismissal (without retention of jurisdiction) on abstention grounds is in the nature of a dismissal under Fed. R. Civ. P. 12(b)(6), for purposes of this appeal we must accept as true the allegations contained in plaintiffs' complaint," *Heritage Farms*, 671 F.2d at 745.

[5] Although the judgment itself was later vacated by the Supreme Court, this court expressed a similar sentiment in a case involving the preemptive scope of federal labor and pension laws. *See Hotel & Restaurant Employees & Bartenders Int'l Union Local 54 v. Danziger*, 709 F.2d 815, 832 (3d Cir. 1983) ("No [*Burford*] argument can be entertained based on a disruption of a state administrative scheme in a case in which the Court is asked to decide whether the very existence of that scheme violates a paramount federal statute."), *vacated on other grounds*, 468 U.S. 491, 104 S.Ct. 3179, 82 L.Ed.2d 373 (1984).

The rationale underlying these decisions is simple and straightforward: "[t]he purpose of *Burford* abstention is to avoid federal intrusion into matters of local concern and which are within the special competence of local courts," *International Bhd. of Elec. Workers*, 614 F.2d at 212 n. 1, whereas "supremacy clause claims are 'essentially one[s] of federal policy,' so that 'the federal courts are particularly appropriate bodies for the application of preemption principles.'" *Kennecott Corp. v. Smith*, 637 F.2d 181, 185 (3d Cir.1980), *quoting Hagans v. Levine*, 415 U.S. 528, 550, 94 S.Ct. 1372, 1386, 39 L.Ed.2d 577 (1974); *see also South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Comm'n*, 744 F.2d 1107, 1123 (5th Cir.1984) (holding that questions of federal preemption are "in no way dependent on local factors or local expertise for their resolution"). In short, then, where "Congress has created a statutory scheme . . . which arguably preempts the local regulation complained of, a fundamental element of *Burford* abstention is thrown into doubt, for we must question whether the case indeed involves an essential local issue." *New Orleans Pub. Serv., Inc.*, 782 F.2d at 1243.

Viewed in the light, we believe that the district court's reliance upon *Burford* was misplaced. Kentucky West and Equitable Gas have raised substantial questions concerning whether the NGA or NGPA directly or indirectly preempt portions of Act 74 and the PUC Order. While we recognize that a decision on the merits of these claims may indeed disrupt Pennsylvania's scheme for regulating retail natural gas rates, "there is, of course, no doctrine requiring abstention merely because resolution of a federal question may result in the overturning of state policy." *Zablocki v. Redhail*, 434 U.S. 374, 379-80 n. 5, 98 S.Ct. 673, 677-78 n. 5, 54 L.Ed.2d 618 (1978).[6]

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[6] We realize that this result conflicts in some respects with that reached by the Fourth Circuit in the *Aluminum Co. of America* case, a case relied upon by the district court. That decision is,

B. *Younger Abstention*

Relying upon *Middlesex County Ethics Comm. v. Garden State Bar Ass'n*, 457 U.S. 423, 102 S.Ct. 2515, 73 L.Ed.2d 116 (1982), the district court determined, *sua sponte*, that abstention was independently required by the doctrine of "Our Federalism," first enunciated in *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971). Kentucky West and Equitable Gas, on the other hand, assert that the district court's decision in this regard constitutes an unwarranted extension of the *Younger* doctrine. The crux of their argument is that the court fell prey to the same error committed by the district court in *New Jersey Educ. Ass'n v. Burke*, 579 F.2d 764 (3d Cir.), *cert. denied*, 439 U.S. 894, 99 S.Ct. 252, 58 L.Ed.2d 239 (1978)—that is, the court "assumed that the mere existence of a pending state proceeding in which the federal questions could be adjudicated automatically invokes *Younger*."

In *Middlesex County*, the Supreme Court set forth a three-pronged test for determining whether a federal court should abstain from interfering with pending state judicial proceedings. "First, there must be an ongoing state judicial proceeding. Second, the proceeding must implicate important state interests. Third, there must be an opportunity in the state proceeding to raise the federal constitutional challenge." *Coruzzi v. State of New Jersey*, 705 F.2d 688, 690 (3d Cir.1983).

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however, at odds with the decisions of the Fifth, Eighth, Ninth, and Eleventh Circuits. In addition, the scope of the Fourth Circuit's decision (and thus the degree of conflict with our holding) is itself unclear. For example, in the *Aluminum Co. of America* case, the court held that *Burford* "abstention is inappropriate where the federal government has preempted the field, or where there is a direct, facial conflict between state and federal statutes." 713 F.2d at 1030 (citations omitted). Thus, given the companies' assertion in this case that 66 Pa. Cons. Stat. § 1318(d) facially conflicts with the NGA and the NGPA, the present decision may not be inconsistent with that of the Fourth Circuit.

In the present case, the district court concluded that Pennsylvania has an important state interest in regulating retail natural gas rates. What the district court failed to appreciate, however, is the equally important federal interest in regulating interstate natural gas rates, authority over which Congress has vested exclusively in FERC. The importance of the latter interest has, moreover, led several courts to conclude that "[t]he legitimate state interest contemplated by *Younger*, *see Middlesex County Ethics Committee v. Garden State Bar Association*, . . . does not exist when the state action has been preempted or foreclosed by the Constitution." *Middle South*, 772 F.2d at 417; *see also Champion Int'l Corp. v. Brown*, 731 F.2d 1406, 1409 (9th Cir.1984) ("Montana has no cognizable state interest in enforcing those age discrimination laws that are preempted by federal law."); *Baggett*, 717 F.2d at 524 (holding that abstention is inappropriate when the "assertion of preemption went to the jurisdiction and power of the state agency to proceed at all"). In short, these courts have concluded that the notion of "comity" embodied by the *Younger* doctrine is "not strained when a federal court cuts off state proceedings that entrench upon the federal domain." *Middle South*, 772 F.2d at 417.

It would, admittedly, be an overstatement to suggest that *Younger* abstention is never appropriate when the question presented is one of preemption. That is not, however, the only factor that counsels against the application of *Younger* abstention in the present case; rather, its procedural posture also dictates that abstention is inappropriate. *Cf. Johnson v Kelly*, 583 F.2d 1242, 1251-52 (3d Cir.1978) (holding that where the pending state proceeding is privately initiated, the state's interest in the outcome of that proceeding is "not appreciably greater that its interest in any private lawsuit in which state legislation may be subjected to a challenge on federal constitutional grounds"); *accord Harris v. Pernsley*, 755 F.2d 338, 344 (3d Cir.), *reh'g denied in banc*, 758

F.2d 83, *cert denied*, — U.S. —, 106 S.Ct. 331, 88 L.Ed. 2d 314 (1985); *Williams v. Red Bank Bd. of Educ.*, 662 F.2d 1008, 1019-20 (3d Cir. 1981); *New Jersey Educ. Ass'n*, 579 F.2d at 771.[7]

"In the typical *Younger* case, the federal plaintiff is a defendant in ongoing or threatened state court proceedings seeking to enjoin continuation of those state proceedings." *Crawley v. Hamilton County Comm'rs*, 744 F.2d 28, 30 (1984). In this case, on the other hand, the federal plaintiffs—Kentucky West and Equitable Gas—are also the state plaintiffs. Moreover, they are not seeking to enjoin any state judicial proceeding; instead, they simply desire to litigate what is admittedly a federal question in federal court, having agreed to dismiss their pending state appeal if the district court assumes jurisdiction over the merits of their complaint. *Cf. New Jersey Educ. Ass'n*, 579 F.2d at 768 (observing that "the relief sought includes a declaration of rights and an injunction against state administrative agencies, rather than an injunction against state court action, a procedure which the plaintiff offered to withdraw").

Under the circumstances, then, we believe that the balance of state and federal interests tips decidedly away from abstention under *Younger*. *New Jersey Educ. Ass'n*, 579 F.2d at 771-72. As a result, the district court abused its discretion when it dismissed the companies' complaint on this basis. To deny Kentucky West and Equitable Gas access to a federal forum simply because of their pending state appeal would be at odds with a fundamental premise of our federal judicial system: that is, "that where Congress has granted concurrent jurisdiction, a plaintiff is free to bring suit in both the state and federal forums for the same cause of action." *Id.* at 769.

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[7] Judge Becker believes that *Harris v. Pernsley* is dispositive on the *Younger* abstention issue, and would not reach the other grounds discussed in Part II.B.

III.

The Pennsylvania Consumer Advocate asserts that, independent of the applicability of *Burford* or *Younger* abstention, the district court's decision can be affirmed on the basis of the doctrine set forth in *Railroad Comm'n of Texas v. Pullman Co.*, 312 U.S. 496, 61 S.Ct. 643, 85 L.Ed. 971 (1941). Similarly, the PUC argues that even if none of the abstention doctrines apply, the district court was still entitled to dismiss the case under the "judicial economy" doctrine first enunciated in *Colorado River*, and later clarified in *Moses H Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). We find these arguments untenable, however.

First, as to the Consumer Advocate's argument, the Supreme Court has stated that "federal courts need not abstain on *Pullman* grounds when a state statute is not 'fairly subject to an interpretation which will render unnecessary' the federal constitutional question." *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 236, 104 S.Ct. 2321, 2327, 81 L.Ed.2d 186 (1984). Although the Consumer Advocate asserts that Act 74 may be amenable to a construction that would obviate the need to decide the constitutional issues presented by this case, he has not pointed to any ambiguity in the statutory scheme, *see Georgevich v. Strauss*, 772 F.2d 1078, 1091 (3d Cir. 1985) (*in banc*), *cert. denied*, — U.S. —, 106 S.Ct. 1229, 89 L.Ed.2d 339 (1986), nor has he pointed to any other "potentially preclusive state law issue," *Harris v. Pernsley*, 755 F.2d at 344. Quite to the contrary, the statute is, in our opinion, not only clear on its face, it is also consistent with prior Pennsylvania case law on this topic. *See Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n*, 77 Pa. Commw. 268, 465 A.2d 735 (1983) (holding that PUC order disallowing part of an electric utility's purchased power expense upon a finding that utility's reliance upon parent company as

a source of power despite cheaper available sources of power constituted an abuse of discretion not preempted by the Federal Power Act). Under such circumstances, abstention from federal jurisdiction under the *Pullman* doctrine is neither required nor permitted.

The PUC did not assert the *Colorado River* doctrine in the district court, nor did that court rely upon it. But even assuming that we need address this issue, there has been no showing of the requisite "exceptional circumstances" to justify the district court's decision to dismiss the companies' complaint. For example, the PUC has not pointed to any Congressional legislation like the McCarran Amendment in *Colorado River* that evinces "a tampering of the policy of enforcing the plaintiff's choice of a federal forum in favor of a policy of avoiding duplicative or inconvenient litigation." *Harris v. Pernsley*, 775 F.2d at 345.

In addition, federal, rather than state, substantive law will govern the present case, a factor that the Supreme Court has stated "must always be a major consideration weighing against [the] surrender [of federal jurisdiction]." *Moses H. Cone*, 460 U.S. at 26, 103 S.Ct. at 942 (footnote omitted). In short, then, we can perceive no way in which the balancing of factors mandated by *Moses H. Cone*, *see id.* at 15-16, 23-26, 103 S.Ct. at 936-37, 941-42, provides the " 'exceptional' circumstances, the 'clearest of justifications' [required] under *Colorado River* to justify the *surrender* of [federal] jurisdiction." *Moses H. Cone*, 460 U.S. at 25-26, 103 S.Ct. at 942 (emphasis in original).

IV.

Kentucky West and Equitable Gas also argue that we should address the merits of their complaint and invalidate Act 74 and the PUC Order. Alternatively, they argue that we should issue a preliminary injunction against the PUC or remand with instructions ordering the district court to do so.

Given the legal and factual complexity of this case, we will decline the companies' express invitation to reach the merits of their complaint or enter the injunction they seek. While several of the questions presented may be purely legal in character, we are not fully convinced that all of the issues posed by their complaint can be decided without factfinding by the district court. In addition, we note that FERC, a nominal defendant in the present case, chose not to address the merits of the companies' complaint, because "[t]o do so seems premature, when the court has not decided whether it will consider the case." Since the final determination of the present case hinges in large part on questions involving the extent of FERC's jurisdiction under the NGA and NGPA, questions peculiarly within the Commission's competence, we believe that the court should reach the merits only after FERC has had an opportunity to respond.

As a result, we will remand this cause to the district court for a decision on the merits; the district court should also expeditiously resolve the companies motion for a preliminary injunction. At that time, the parties to this appeal will be able to supplement the record if they so desire, and to submit any additional briefing requested by that court.

V.

Accordingly, the judgment of the district court dismissing the complaint will be reversed and the cause remanded for further proceedings consistent with this opinion.

APPENDIX D

UNITED STATES DISTRICT COURT
M.D. PENNSYLVANIA

Civ. A. No. 85-1514

KENTUCKY WEST VIRGINIA GAS COMPANY, et al.,
Plaintiffs,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, et al.,
Defendants.

Nov. 6, 1985

Thomas & Thomas, Harrisburg, Pa., William A. Mogel, Ross, Marsh & Foster, Washington, D.C., for plaintiffs.

Eric N. Wise, Arlington, Va., for American Gas Assoc.

Joanne Leveque, Washington, D.C., for F.E.R.C.

Charles Hoffman, Chief Counsel, Pa. PUC, Harrisburg, Pa., Alphonso Arnold, Jr., Harrisburg, Pa., for Pennsylvania Public Utility Com'n.

Michael Finio, Eugene Waye, Harrisburg, Pa., for Atty. General (Intervener).

Philip McClelland, Harrisburg, Pa., for Consumer Advocate (Intervener).

MEMORANDUM

CALDWELL, District Judge.

I. *Introduction.*

Plaintiffs, Kentucky West Virginia Gas Company (Kentucky West) and Equitable Resources, Inc. (Equitable), have filed a complaint for preliminary and perma-

nent injunction and a declaratory judgment against defendants, the Pennsylvania Public Utility Commission (PUC) and its individual members, Linda C. Taliaferro, Frank Fischl and Bill Shane. The Federal Energy Regulatory Commission (FERC) has also been named as a defendant. Plaintiffs claim that a PUC order directed at Equitable, dated August 29, 1985, and certain sections of Pennsylvania Act No. 1984-74, pursuant to which the order was issued, violate the commerce clause,[1] the supremacy clause,[2] and the first, fifth and fourteenth amendments.[3] Plaintiffs also claim that the Act No. 1984-74 and the agency order violate certain sections of the Natural Gas Act (NGA), 15 U.S.C. § 717 *et seq.* and the Natural Gas Policy Act (NGPA), 15 U.S.C. § 3301 *et seq.*

Motions to intervene were filed by David M. Barasch, Consumer Advocate for the Commonwealth of Pennsylvania, the Office of the Attorney General of Pennsylvania and the American Gas Association (AGA), a national trade association representing the interests of gas companies which distribute and transport natural gas. Barasch and the Attorney General were permitted to intervene as defendants. The AGA was allowed into the suit as an amicus curiae.

On October 30, 1985, a hearing on the requested injunctive and declaratory relief was held and the parties have briefed and argued their positions. Plaintiffs' request is therefore ripe for disposition.

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[1] The commerce clause authorizes Congress to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3.

[2] The supremacy clause provides, in relevant part, as follows: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land, ..." U.S. Const. art. VI, cl. 2.

[3] U.S. Const. amend. I, V, and XIV, § 1.

II. *Background.*

Plaintiff, Equitable, produces, purchases, transports, stores, distributes and sells natural gas in both interstate and intrastate commerce. Subject to the authority of the PUC it retails gas to approximately 240,000 customers in southwestern Pennsylvania. Equitable purchases approximately 80% of its gas from three interstate suppliers. One of these is plaintiff, Kentucky West, with which Equitable has a long term contract for purchasing gas. Kentucky West is a wholly owned subsidiary of Equitable Resources, Inc. and Equitable is a division of that company. Kentucky West's wholesale rates for natural gas are regulated by FERC which approved the rates charged to Equitable.

On March 1, 1985, Equitable sought approval of new rates for its retail customers by filing a computation of Annual Purchased Gas Adjustment pursuant to 66 Pa. C.S. § 1307(f). The PUC investigated the justness and reasonableness of the proposed rates under authority conferred upon it by Act No. 1984-74. See 66 Pa.C.S. § 1307 (f)(2). Fourteen days of hearings were held. The PUC Order of August 29, 1985 followed in which the agency disallowed the requested rates because it found that Equitable had not pursued at least cost fuel procurement policy, consistent with its obligation to provide safe, adequate and reliable service.[4] Specifically, the PUC found

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[4] 66 Pa. C.S. § 1318, a part of No. 1984-74, provides, in pertinent part, as follows:

> (a) General rule.—In establishing just and reasonable rates for those natural gas distribution utilities with gross intrastate operating revenues in excess of $40,000,000 under section 1307(f) (relating to sliding scale of rates; adjustments) or 1308(d) (relating to voluntary changes in rates) or any other rate proceeding, the commission shall consider the materials provided by the utilities pursuant to section 1317 (relating to regulation of natural gas costs). No rates for a natural gas distribution utility shall be deemed just and reasonable unless the commission finds that the utility is pursuing a least cost

that Equitable had failed to use its own production and that of other suppliers to keep costs down. Rather, it had

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fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers. In making such a determination, the commission shall be required to make specific findings which shall include, but need not be limited to, findings that:

(1) The utility has fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission.

(2) The utility has taken all prudent steps necessary to negotiate favorable gas supply contracts and to relieve the utility from terms in existing contracts with its gas suppliers which are or may be adverse to the interests of the utility's ratepayers.

(3) The utility has taken all prudent steps necessary to obtain lower cost gas supplies on both short-term and long-term bases both within and outside the Commonwealth, including the use of gas transportation arrangements with pipelines and other distribution companies.

(4) The utility has not withheld from the market or caused to be withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

(b) Limitation on gas purchased from affiliates.—In any instance in which a gas distribution utility purchases all or part of its gas supplies from an affiliated interest, as that term is defined in section 2101 (relating to definition of affiliated interest), the commission, in addition to the determinations and findings set forth in subsection (a), shall be required to make specific findings with regard to the justness and reasonableness of all such purchases. Such findings shall include, but not be limited to findings:

(1) That the utility has fully and vigorously attempted to obtain less costly gas supplies on both short-term and long-term bases from nonaffiliated interests.

(2) That each contract for the purchase of gas from its affiliated interest is consistent with a least cost fuel procurement policy.

(3) That neither the utility nor its affiliated interest has withheld from the market any gas supplies which

purchased higher priced gas from Kentucky West. Equitable filed a Petition for Review of the order in the Pennsylvania Commonwealth Court on September 27, 1985. This lawsuit was filed on October 11, 1985.

III. *Discussion.*

Briefly, plaintiffs mainly argue on the merits that Pennsylvania's attempt to require Equitable to follow a least cost procurement policy intrudes upon the FERC's authority to set Kentucky West's interstate rate for gas. In their view, Pennsylvania must accept the FERC approved rate in considering Equitable's intrastate rate. To do otherwise violates the commerce and supremacy clauses.

Initially, however, we will consider two defense arguments which would, if successful, require us to dismiss this action without reaching the merits. The PUC contends that, pursuant to the Johnson Act, 28 U.S.C. § 1342, we do not have jurisdiction over this case. The agency and defendant Barasch, further contend that, in any event, we should exercise our discretion and abstain from adjudicating plaintiffs' claims. Both defendants rely upon *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943) to support the latter argument and the PUC further argues that abstention under *Railroad Commission of Texas v. Pullman*, 312 U.S. 496, 61 St.Ct. 643, 85 L.Ed. 971 (1941) is appropriate. Since the Johnson Act may, as the PUC contends, preclude jurisdiction over this action, we turn to that issue first.

The Johnson Act provides as follows:

> The district courts shall not enjoin, suspend or restrain the operation of, or compliance with, any order affecting rates chargeable by a public utility and made by a State administrative agency or a

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should have been utilized as part of a least cost fuel procurement policy.

ratemaking body of a State political subdivision, where:

(1) Jurisdiction is based solely on diversity of citizenship or repugnance of the order to the Federal Constitution; and,

(2) The order does not interfere with interstate commerce; and,

(3) The order has been made after reasonable notice and hearing; and,

(4) A plain, speedy and efficient remedy may be had in the courts of such State.

All of the conditions of the Act must be satisfied to support a finding of no jurisdiction. *Zucker v. Bell Telephone Company*, 373 F.Supp. 748 (E.D.Pa.1974), *aff'd mem.* 510 F.2d 971 (3d Cir.1975), *cert. denied*, 422 U.S. 1027, 95 S.Ct. 2621, 45 L.Ed.2d 684 (1975). In the instant case, the first condition has not been met because jurisdiction is not based solely upon repugnance of the order to the federal constitution. Plaintiffs also claim that Act No. 1984-74 violates the commerce and supremacy clauses. *See International Brotherhood of Electrical Workers, Local Union No. 1245 v. Public Service Commission*, 614 F.2d 206 (9th Cir.1980). We also conclude that the order does not interfere with interstate commerce. Although defendants argue that only intrastate commerce is involved, for the purposes of the motions to dismiss, we believe that we must accept plaintiffs' contention concerning the affect upon interstate commerce. *See Aluminum Company of America v. Utilities Commission*, 713 F.2d 1024 (4th Cir.1983), *cert. denied*, 465 U.S. 1052, 104 S.Ct. 1326, 79 L.Ed.2d 722 (1984). Accordingly, the Johnson Act does not bar jurisdiction over this case.

Turning to the abstention issue, we agree with the PUC and Barasch that, although we have jurisdiction

over this case, we should abstain from adjudicating it. We believe that, as urged by the defendants, *Burford* abstention applies here, and also an abstention doctrine not raised by them, *Younger* abstention under *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971).

In *Pike County Light and Power Co. v. Pennsylvania Public Utility Commission*, No. 82-1608 (M.D.Pa. Jan. 13, 1983), we applied *Burford* to a factual situation analogous to the case at bar. In *Pike County*, plaintiff, an electrical power utility, contested a PUC order disallowing a portion of its rate request. The disallowance was based, in part, on the PUC's determination that the utility's purchased power expenses, already FERC approved, were unreasonable. Plaintiff had appealed the order in the state courts.

We abstained based upon the concern of the Court in *Burford* for respecting the rightful independence of state governments and to further the harmonious relationship between state and federal authority. We also quoted from the court's discussion of *Burford* in *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 814 S.Ct. 1236, 1244-45, 47 L.Ed.2d 483 (1976) (emphasis in *Pike County*):

> Abstension is . . . appropriate where there have been presented difficult questions of state law bearing on policy problems of substantial import whose importance transcends the result in the case then at bar. . . . In some cases, however, the state question itself need not be determinative of state policy. *It is enough that exercise of federal review of the question in a case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern.*

These considerations are equally compelling in the case at bar. The courts, while recognizing the federal pre-

rogative to regulate the interstate aspects of utilities' sales have also respected the great interest the states have in regulaing retail utility rates within their boundaries. *See Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983). We conclude that abstention under *Burford* is appropriate here. *See also Aluminum Company of America v. Utilities Commission*, *supra*; *Aims Enterprises, Inc. v. Muir*, 609 F.Supp. 257 (M.D. Pa.1985).

Younger v. Harris, *supra*, also indicates that we should abstain. *Younger* dealt with the propriety of a district court's interference with a state criminal proceeding but it has been applied to noncriminal state proceedings. As stated by the court in *Middlesex County Ethics Committee v. Garden State Bar Ass'n*, 457 U.S. 423, 432, 102 S.Ct. 2515, 2521, 73 L.Ed.2d 116, 124 (brackets added):

> The policies underlying *Younger* are fully applicable to noncriminal judicial proceedings when important state interests are involved. [citations omitted]. The importance of the state interest may be demonstrated by the fact that the noncriminal proceedings bear a close relationship to proceedings criminal in nature. . . . Proceedings necessary for the vindication of important state policies or for the functioning of the state judicial system also evidence the state's substantial interest in the litigation. [citations omitted]. Where vital state interests are involved, a federal court should abstain "unless state law clearly bars the interposition of the constitutional claims." *Moore* [*v. Sims*, 442 U.S. 415, 426, 99 S.Ct. 2371, 2379, 60 L.Ed.2d 994, 1005 (1979)]. "[T]he . . . pertinent inquiry is whether the state proceedings afford an adequate opportunity to raise the constitutional claims. . . ." *Id.*, at 430, 99 S.Ct. at 2371, 60 L.Ed.2d 994.

The PUC investigation here did not implicate the state judicial system but Equitable has now involved the state judiciary by filing its petition for review in the Commonwealth Court. We believe therefore that the threefold question which arose in *Middlesex* may be asked here as well.[5] It may be paraphrased as follows: first, do the proceedings in the Commonwealth Court constitute an ongoing state judicial proceeding; second, do the proceedings implicate an important state interest; third, is there an adequate opportunity in the state proceedings to raise constitutional challenges. *See Aims Enterprises, Inc., supra.*

Obviously, the first part of the question may be answered affirmatively. Also, we have already concluded that Pennsylvania has an important state interest in regulating retail gas prices. Finally, plaintiff Equitable has an adequate opportunity to raise federal constitutional challenges in the state proceedings. See Pa.R.App. P. 1501 *et seq.* In fact, it has already done so in its petition for review in the Commonwealth Court. Therefore, *Younger* indicates we should abstain.

We will issue an appraise order.

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[5] In any event, as noted previously, important state policies dealing with the setting of retail natural gas rates are implicated here.

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 87-5052

KENTUCKY WEST VIRGINIA GAS COMPANY, et al.

vs.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, et al.

KENTUCKY WEST VIRGINIA GAS COMPANY and EQUITABLE GAS COMPANY, a division of Equitable Resources, Inc.,

Appellants

On Appeal From the United States District Court
for the Middle District of Pennsylvania

D.C. Civil 85-1514

Present: SEITZ, MANSMANN and GREENBERG, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Middle District of Pennsylvania and was argued by counsel August 7, 1987.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court entered December 23, 1986 be, and the same is hereby affirmed. Costs taxed against the appellants.

ATTEST

/s/ Sally Mrvas
Clerk

Dated: January 19, 1988

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 87-5052

KENTUCKY WEST VIRGINIA GAS CO., ETC.
Appellants,

vs.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*

SUR PETITION FOR REHEARING

Present: GIBBONS, *Chief Judge*, SEITZ, WEIS, HIGGINBOTHAM, SLOVITER, BECKER, STAPLETON, MANSMANN, GREENBERG, HUTCHINSON, SCIRICA, and COWEN, *Circuit Judges.*

The petition for rehearing filed by appellants in the above entitled case having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

BY THE COURT,

/s/ Carol Los Mansmann
Circuit Judge

DATED: February 16, 1988

APPENDIX G

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held August 28, 1985

Commissioners Present:

Linda C. Taliaferro, Chairman
James H. Cawley
Frank Fischl
Bill Shane

R-850038

PENNSYLVANIA PUBLIC UTILITY COMMISSION

R-850038C001

OFFICE OF CONSUMER ADVOCATE

R-850038C002

EQUITABLE INDUSTRIAL INTERVENORS

v.

EQUITABLE GAS COMPANY

OPINION AND ORDER

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OPINION AND ORDER

BY THE COMMISSION:

Before the Commission for review is the Recommended Decision of Administrative Law Judge (ALJ) Joseph J. Klovekorn dated June 26, 1985, which, *inter alia*, recommended (i) that Equitable Gas Company (Equitable or the Company) file rates designed to produce a gas cost rate of $3.6084 per MCF, and (ii) that Equitable certify to the Commission, in the Company's next Section 1307(f) filing that it has employed separate, independent counsel, with access to a technical staff separate and independent from its affiliated pipeline supplier, Kentucky West Virginia Gas Company to represent it before the Federal Energy Regulatory Commission. The ALJ also made certain specific findings concerning Equitable's gas costs vis-a-vis a least cost procurement policy required under Section 1318 of the Public Utility Code, 66 Pa. C.S. § 1318, and the ALJ also made specific findings regarding Equitable's compliance with Section 1317 of the Public Utility Code, 66 Pa. C.S. § 1317.

Exceptions and Reply Exceptions to the Recommended Decision were filed by Equitable, the Office of Consumer Advocate (OCA) and by Commission Trial Staff (Trial Staff).

I. HISTORY OF PROCEEDINGS

On March 1, 1985, Equitable Gas Company (Equitable or the Company), a division of Equitable Resources, Inc., filed with the Commission a computation of Annual Purchased Gas Adjustment pursuant to Section 1307(f) of the Public Utility Code, 66 Pa. C.S. § 1307(f), and the Commission's Regulations Re Filing of Rate Changes Implementing Act 74, 52 Pa. Code § 53.61, *et seq.* The Sec-

tion 1307(f) filing proposes increases in rates effective September 1, 1985, reflecting (1) Equitable's projected natural gas costs for the twelve months ending August 31, 1986 and (2) a reconciliation plan for the treatment of over/undercollections during the transition period from the current gas cost rate mechanism to the Section 1307(f) procedure. As originally filed on March 1, 1985, the Section 1307(f) filing proposed a gas cost of $4.0530/Mcf, an increase of $0.3855 over the company's gas costs presently reflected in rates. Subsequently, the projected gas cost was revised downward to $3.9704/Mcf, an increase of $0.3029 over the company's gas costs presently reflected in rates. On June 14, 1985, another revision was filed reflecting estimated gas costs of $3.785/Mcf, an increase of $0.1210.

By Order entered March 11, 1985, the Commission instituted an investigation to determine the lawfulness, justness and reasonableness of the rates proposed in the Section 1307(f) filing and to satisfy the requirements of Sections 1307, 1317 and 1318 of the Public Utility Code, 66 Pa. C.S. §§ 1307, 1317 and 1318. In addition to the Commission's investigation docketed at R-850038, Complaints against the Section 1307(f) filing were filed by the Office of Consumer Advocate and the Equitable Industrial Intervenors, an ad hoc association of six Equitable customers served under Rate 4A Industrial Service Large, consisting of Enamel Products & Plating Company, General Electric Company, General Motors Corporation, Koppers Company, Inc., Nabisco, Inc. and Woodings Verona Tool Works, Inc. Equitable filed Answers to each of the Complaints. The Complaints were consolidated with the Commission's investigation for the purposes of hearing, briefing and disposition. In addition, a Petition to Intervene was received from the Pennsylvania Natural Gas Associates. The Petition was unopposed and was granted by the ALJ.

A prehearing conference was held on March 15, 1985, at which the Commission's investigation into Equitable's Section 1307(f) filing was consolidated for hearing purposes with the Commission's investigation into Supplement No. 50 to Tariff Gas Pa. P.U.C. No. 20, which was filed by Equitable on January 4, 1985 and proposed changes in rates, rules and regulations designed to increase base rate revenues by approximately $36,273,000. Evidentiary hearings were held on April 2, 12, 23, 24, 25, 29 and 30 and May 2, 3, 13, 14, 16 and 20, 1985. In addition, a consolidated Public Input Hearing was held in Pittsburgh on May 2, 1985.

Equitable presented its Section 1307(f) evidence primarily through four witnesses. Trial Staff and the OCA each presented one witness. Briefs and Reply Briefs have been received from the Company, Trial Staff, OCA and the Equitable Industrial Intervenors.

As noted above, on June 14, 1985, at the same time that Reply Briefs were filed, Equitable filed a revised calculation of Item 53.64(a)(z) to its Purchased Gas Cost filing under Section 1307(f) for rates to become effective September 1, 1985.

According to Equitable, subsequent to closing the record in this proceeding, Equitable received notification of rate reductions by two of its pipeline suppliers, Tennessee Gas Pipeline Company (Tennessee) and Kentucky West Virginia Gas Company (Kentucky West). Tennessee, in its PGA filing with the FERC (Docket No. TA85-29) for rates effective July 1, 1985, has reduced its commodity rate from $3.5388 to $3.1785 per dekatherm. In addition, Kentucky West, by letter dated June 7, 1985, has advised that in its PGA filing with the FERC for rates to become effective November 1, 1985, it plans to reduce its tariff rate from $3.6052 to about $3.2701 per dekatherm (excluding the GRI surcharge of $.125). The revised calculation submitted by Equitable

reflects estimated gas costs of $3.7885 per Mcf of sales for the projected period September 1, 1985 through August 31, 1986, or an increase of $0.1210 per Mcf over gas costs reflected in current rates. This compares to an increase of $0.3029 reflected in Equitable Exhibit VA and an increase of $0.3855 reflected in Equitable's original Section 1307(f) filing in Exhibit V.

By letter dated June 18, 1985, the Administrative Law Judge requested those parties sponsoring adjustments to the Company's original claim to update those adjustments in light of the Company's most recent revisions.

By letter dated June 18, 1985, the Trial Staff urges that the Company's most recent update should be disregarded since it directly contravenes the Commission's regulations implementing Act 74.

Section 53.64(e) of 52 Pa. Code states that all updates relating to changes in purchased fuel expenses must be received at least thirty calendar days prior to the close of the record and with opportunity provided for all parties to review and inquire concerning the information contained in the updates. The record here closed May 20, 1985 (Tr. 1470).

Trial Staff also argues that the spirit of the regulation has been violated since the parties were not provided with an opportunity to review the proposed change in requested rate before the update was submitted.

Trial Staff argues that Equitable has made no effort to obtain the concurrence of the parties in making this revision and has not even acknowledged the conflict that the update creates with Commission regulations.

According to Trial Staff, the fact that the record has been closed makes the Company's unilateral action no more justifiable. The Company was hardly compelled to take this action. It could have alerted the parties to its desire to make revisions and an amicable concurrence on

the issue might have been achieved. Questions relating to whether FERC has approved the new rates and the mathematics of the revisions could have been answered. Instead, Trial Staff notes, the problem the regulations attempted to eliminate—unreviewed changes in claim being presented after the record is closed—has been laid squarely at the ALJ's and Commission's doorstep.

At the time of Trial Staff's letter, Equitable had not, formally or informally, requested a waiver of § 53.64(e). It was Trial Staff's position that such a request should be made and the parties given an opportunity to obtain information, review the update and file a response. The ALJ recommended that until a determination has been made to recommend waiver of the regulation, the update should not be recognized as an effective tariff modification by Equitable.

By letter received June 21, 1985, Equitable has made a request for the waiver of the 30 day requirement of Section 53.64(f).

The ALJ further concluded that there must be some finality to a rate proceeding. *Pittsburgh v. Pa. P.U.C.*, 187 Pa. Super. Ct. 341, 144 A.2d 648 (1958). For this purpose, the regulations clearly set up a deadline for the filing of revisions to a utility's claims. ALJ Klovekorn noted that to file a request for waiver at the stage of the proceedings immediately preceding the time when the Administrative Law Judge's recommendations must be filed, would deny those parties opposing the claim of their procedural due process rights. We agree with the ALJ.

The Company's update, having been filed in contravention of the Commission's Rules of Procedure, will not be considered here. We do not share Equitable's legal conclusion that due process rights do not attach to the update since the Company is proposing to *reduce* its 1985 PGA estimate. Due process considerations apply to both

increases and decreases in gas costs, and this Commission would clearly be remiss if it refused to recognize due process rights in the case of a cost decrease.

II. THE COMPANY

Equitable Gas Company is the regulated utility division of Equitable Resources, Inc. Equitable Resources, Inc. was incorporated as Equitable Gas Company on March 31, 1926 under Pennsylvania law following the consolidation and merger of Equitable Gas Company and Monongahela Natural Gas Company under Agreement dated September 15, 1925 (Equitable Exhibit I, Item IA1). Effective October 1, 1984, the name of the company was changed from Equitable Gas Company to Equitable Resources, Inc.

Equitable Resources, Inc. is a publicly held corporation and its common stock is traded on the New York and Philadelphia Stock Exchanges. The Equitable Gas Company division is engaged in the production, purchase, storage, transmission, distribution and sale of natural gas and serves customers in Pennsylvania, West Virginia and Kentucky.

At August 31, 1984, the Equitable Gas Company division served 239,966 residential, commercial and industrial customers in the City of Pittsburgh and adjacent territories in Allegheny, Armstrong, Butler, Greene, Indiana, Washington and Westmoreland Counties in southwestern Pennsylvania, and 10,688 residential, commercial and industrial customers in the northern portion of West Virginia. Approximately 4,611 customers were served in Kentucky, but the Kentucky service area is separate, distinct and isolated from the major integrated system in Pennsylvania and West Virginia (Equitable Exhibit I, Item I-A-1 and Equitable Exhibit III, Item III-E-4a).

Of the 239,966 total customers served by the Company in Pennsylvania as of August 31, 1984, 224,117 were

residential customers, of which 219,410 were heating, 15,534 were commercial customers, of which 14,791 were heating and 315 were industrial customers (Equitable Exhibit III, Item III-E-19).

Equitable Resources, Inc. is the sole owner of Kentucky West Virginia Gas Company, Equitable Resources Energy Company (formerly Philadelphia Oil Company) and Equitable Gas-Energy Company. Kentucky West Virginia Gas Company has three wholly-owned subsidiaries, Kentucky Hydrocarbon Company, Berea Gathering Company and Kepco, Inc. Equitable Resources Energy Company has one wholly-owned subsidiary, Equitable Energy, Inc. Kepco, Inc. has one wholly-owned subsidiary, Union Drilling Company (Equitable Exhibit I, Item I-A-1).

III. SUMMARY OF POSITIONS

Act 74 of 1984 permits each natural gas distributor with gross intrastate annual operating revenues in excess of $40 million to file tariffs reflecting changes in their natural gas costs. Before such tariffs can become effective, however, the Commission must find that the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service. Specifically, the Commission must find that:

(1) The utility has fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission.

(2) The utility has taken all prudent steps necessary to negotiate favorable gas supply contracts and to relieve the utility from terms in existing contracts with its gas suppliers which are or may be adverse to the interests of the utility's ratepayers.

(3) The utility has taken all prudent steps necessary to obtain lower cost gas supplies on both short-

term and long-term bases both within and outside the Commonwealth, including the use of gas transportation arrangements with pipelines and other distribution companies.

(4) The utility has not withheld from the market or caused to be withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

Where, as here, the utility purchases a part of its gas supplies from an affiliated interest, the Commission is required to make specific findings with regard to the justness and reasonableness of all such purchases. These findings include:

(1) That the utility has fully and vigorously attempted to obtain less costly gas supplies on both short-term and long-term bases from nonaffiliated interests.

(2) That each contract for the purchase of gas from its affiliated interest is consistent with a least cost fuel procurement policy.

(3) That neither the utility nor its affiliated interest has withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

Equitable argues that it has in the past and will continue in the future to pursue such a least cost fuel procurement policy.

To accommodate its current excess deliverability of supply, Equitable argues that a long run least cost procurement strategy of prorata cut backs below minimum bill levels best protects the availability of Equitable's supply mix into the foreseeable future, when shortages and curtailments will once again threaten, and over the longer term will result in lower gas costs for its cus-

tomers. In addition, Equitable maintains that it has taken and will continue to take all prudent steps necessary and possible to renegotiate contract terms with most of its suppliers, including its affiliate, Kentucky West, in order to reduce contract entitlements or prices. At the same time, Equitable claims that it has been soliciting for additional lower priced supply from independent producers in order to maintain its long term supply mix on terms most favorable to Equitable's customers.

Equitable argues that while it has had to cut back takes from its pipeline suppliers below minimum bill levels in recent years, neither Equitable nor Equitable's affiliate, Kentucky West, has withheld from the market any supplies which should have been utilized as part of a least cost fuel procurement strategy.

Equitable maintains that its contract with its affiliated pipeline supplier, Kentucky West, is consistent with a least cost fuel procurement policy. Kentucky West has been Equitable's most reliable pipeline supplier and Equitable expects that Kentucky West's rates will continue to fall as the marketplace continues to exert downward pressure on gas prices. It further maintains that any attempt by the Commission to regulate the price of Kentucky West's gas or to consider the issue of Kentucky West's gas procurement practices would be invalid as violative of the federal preemption doctrine.

Equitable states that it fully and vigorously represents, either on an individual basis or through its membership in trade organizations, the interests of its ratepayers in proceedings before the FERC.

Equitable maintains that it has taken and will continue to take all prudent steps necessary and possible to obtain lower cost gas supplies on both short-term and long-term bases, consistent with its service obligations. It points out that supplier refunds, which are applied retroactively due to the FERC's administrative proce-

dure in rate matters, may reduce the price of gas that had been considered "high price" gas below that of the "least price" supply at the time. Furthermore, should the Commission presently adjust any prices paid by Equitable to its pipeline suppliers and those suppliers subsequently issue refunds applicable to the adjusted period, such refunds would not be flowed through to customers.

Trial Staff and the OCA argue that Equitable has failed to meet its burden that it is entitled to establish rates designed to recover its purchased gas costs. They maintain that Equitable has not pursued a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers.

According to these parties, Equitable's gas cost rate is unjust and unreasonable as it reflects costs that are excessive and imprudently incurred.

Trial Staff argues that during 1983 and 1984, Equitable has intentionally withheld from the market less expensive gas in the form of company-owned production and local production. In place of this gas, Equitable has favored more expensive pipeline gas. Meriting particular scrutiny, according to Trial Staff, is Equitable's practice of severely curtailing its company-owned production while increasing its takes of more expensive gas from Kentucky West, its affiliated company.

For the projected period under Section 1307(f), 66 Pa. C.S. § 1307(f), Trial Staff maintains, Equitable does not evidence a least cost procurement policy consistent with its obligation to provide safe, adequate and reliable service. The Company is not exercising its available discretion in the short-term to turn back more expensive sources of pipeline gas in favor of less expensive pipeline gas.

In addition, the OCA recommends that certain cost elements included by Equitable in its Section 1307(f) filing should more appropriately be examined in the Sec-

tion 1308 base rate portion of this case. These cost elements are lost and unaccounted for gas, company use gas and the GRI surcharge.

We will consider the Company's filing and the proposed adjustments thereto.

IV. PROJECTED GAS SUPPLY COSTS DURING THE PERIOD SEPTEMBER 1, 1985 AUGUST 31, 1986

Equitable's gas supply is comprised of (1) company produced gas from wells located in Pennsylvania and West Virginia, (2) gas purchased from local producers in Pennsylvania and West Virginia and (3) gas purchased from FERC regulated interstate pipeline suppliers (Equitable Statement No. 6, pp. 3-4). For the twelve months ending August 31, 1986, Equitable projects company production used in providing service to Pennsylvania jurisdictional customers to be as follows (Tr. 1236):

Company Production	MMCF
Pennsylvania	1,072
West Virginia	1,634 [2,028 x .8056]

For the twelve months ending August 31, 1986, Equitable projects the following purchases from the following suppliers at the following total costs (Equitable Exhibit V-A, Sheets 17 and 18):

Supplier	MMCF	Cost In Dollars
Texas Eastern Transmission Corporation (DCQ)-C	24,625	$86,100,000
Texas Eastern Transmission Corporation (WS)	0	48,000
Tennessee Gas Pipeline Company	13,935	59,331,000
Kentucky West Virginia Gas Company	12,938	51,347,000
[Exchange Differential]		4,139,000
Appalachian Supply	6,349	16,774,000
New Appalachian Supply	933	3,507,000
Cities Service	682	2,325,000

Equitable contends that the sources of supply as projected above, which include company produced supply and supply purchased from local producers and from FERC regulated interstate pipeline suppliers, reflect a least cost fuel procurement policy consistent with Equitable's obligation, pursuant to Act 74 and the Commission's regulations promulgated thereunder, to provide safe, adequate and reliable service to its customers. This is contested by Trial Staff and the OCA.

Equitable's largest supply source is Texas Eastern Transmission Corporation (Texas Eastern). Equitable purchases gas from Texas Eastern under two contracts at FERC approved Tariff Rate Schedules DCQ-C and WS. Rate Schedule DCQ-C represents rates applicable to Texas Eastern's Zone C customers. Under this contract, Equitable can purchase up to 109,207 dekatherms per day, or 39,860,555 dekatherms per year, unless Texas Eastern imposes curtailment. The DCQ-C rate schedule includes a monthly demand charge and a commodity charge. WS represents Winter Service. Under this contract, Equitable can purchase up to 93,420 dekatherms for the winter season at a daily maximum of 1,557 dekatherms. The WS rate schedule also consists of a demand and commodity charge (Equitable Statement No. 6, p. 10).

Rate Schedules DCQ-C and WS each contain a minimum bill provision. Under DCQ-C, the minimum bill consists of the monthly demand charge plus 75% of the maximum daily contract quantity times the number of days in the month times the commodity charge. Under WS, the entire volume of 93,420 dekatherms must be taken or paid for during the winter season, unless curtailment is in effect.

There are five locations where the facilities of Texas Eastern connect with those of Equitable. All points of delivery are in Pennsylvania, the one nearest Pittsburgh

being on the eastern extremity of the service area near Delmont in Salem Township, Westmoreland County (Pennsylvania Quadrangle No. 3A). The Delmont connection is essential for Equitable to provide adequate gas supply to this portion of the Company's system during the winter heating months.

Texas Eastern's first deliveries were received in May 1947 at a daily maximum of 30,000 Mcf. The firm daily delivery quantity was changed to 40,000 Mcf in 1956, to 55,000 Mcf in September 1957, to 76,200 Mcf in November 1957, to 90,200 Mcf in 1958, to 100,200 Mcf in 1961, and to 105,200 Mcf in 1964. In 1973, the units of measurement were changed from cubic feet to dekatherms (wet) which translated to a daily maximum of 107,307 dekatherms. Then in 1979, the units of measurement were changed to dekatherms on a dry basis which resulted in the present DCQ-C daily maximum of 109,207 dekatherms (Equitable Statement No. 6, pp. 9-10).

Equitable claims that although Texas Eastern is projected to be Equitable's lowest cost source of supply during the twelve months ending August 31, 1986, it believes that in the long run Texas Eastern's supply is not likely to be such a bargain, not only from a cost perspective, but from a supply adequacy point of view as well. Equitable states that Texas Eastern's gas is low priced today because a significant portion of its supply is provided at extremely low prices under a Gulf Oil Corporation Warranty Contract due to expire in 1989 at the latest. Replacing this increment of gas supply at today's costs will increase Texas Eastern's overall weighted average cost of gas by about $.50/MMBtu (Equitable Statement No. 13, pp. 15-16; Tr. 1157; 1219; Equitable Exhibit 16M-1, Item No. 11).

According to Equitable, the expiration of the Gulf Warranty Contract will also reduce Texas Eastern's available supply by 16 percent.

Equitable's second largest supply source is Tennessee Gas Pipeline Company (Tennessee). Equitable purchases gas from Tennessee under a long term contract at FERC-approved Tariff Rate Schedule CD-4. Rate Schedule CD-4 represents rates applicable to Tennessee's Zone 4 customers. The maximum volume available from Tennessee under this contract is 75,863 dekatherms per day or an annual volume of 27,689,995 dekatherms. The CD-4 rate schedule consists of a demand, commodity and gas charge. The gas charge represents the cost of gas to Tennessee, while the commodity charge represents all other Tennessee expenses not included in the demand or gas charges. The commodity and gas charges combined are the equivalent to most other pipelines' commodity charge (Equitable Statement No. 6, pp. 10-11). Rate schedule CD-4 contains a minimum bill provision which consists of the maximum daily volume times the number of days in the month times the combined commodity/gas charge (Equitable Statement No. 6, p. 11).

Equitable receives gas from Tennessee's system only at the northwestern tip of Equitable's Pittsburgh service area in Marshall Township, Allegheny County (Pennsylvania Quadrangle No. 46). This connection is also essential for Equitable to provide adequate gas supply to this portion of the Company's system during the winter heating months. Tennessee's first deliveries were received in January 1951 at a daily maximum of 45,000 Mcf. This was increased to 74,375 Mcf in 1956. In 1972, the pressure base was changed for measurement purposes, and the firm daily delivery quantity became 75,863 Mcf or 77,760 Dkt/day (Equitable Statement No. 6 p. 10). In a recent FERC filing at FERC Docket No. CP84-441-003, Tennessee proposed to reduce Equitable's entitlement to 65,325 Dkt/day, as Equitable had requested.

According to Equitable, Tennessee has historically been the more reliable of its southwest pipeline suppliers. During the curtailments of the 1970's, Tennessee, unlike

Texas Eastern, did not need to curtail deliveries to Equitable until the last quarter of 1974.

Equitable's third largest supply source is Kentucky West Virginia Gas Company (Kentucky West). Equitable purchases gas from Kentucky West under a long term contract at FERC approved Tariff Rate Schedule PLS-1. PLS-1 represents a pipeline service rate for gas delivered in Kentucky. The maximum volume available from Kentucky West under this contract is 71,013 dekatherms per day. The PLS-1 rate schedule contains only a commodity charge; no demand charge or gas charge is included therein. Rate Schedule PLS-1 contains a minimum bill provision that requires Equitable to take or pay for a minimum of gas not less than that volume determined by multiplying the number of days in a month by 66⅔% of the maximum daily contract quantity (Equitable Statement No. 6, p. 12).

Since there is no interconnection of facilities between Equitable and Kentucky West, Equitable's gas purchases from Kentucky West are transported into its Pennsylvania/West Virginia system through the facilities of the Columbia Gas Transmission Corporation (Columbia) under a transportation and exchange agreement, the terms of which have been approved by the FERC. The cost incurred by Equitable for this utilization of Columbia's facilities is set forth in Columbia's FERC approved Rate Schedule X-70.

Equitable, in accordance with this transportation and exchange agreement, delivers to Columbia in Kentucky the gas purchased from Kentucky West, following which Columbia delivers an equivalent volume of gas, less shrinkage, to Equitable, at two interconnections, one in Pennsylvania and one in West Virginia. The Pennsylvania interconnection is located on the eastern side of Waynesburg in Franklin Township, Greene County (Pennsylvania Quadrangle No. 7). The West Virginia in-

terconnection is located north of Smithfield, in Grant District, Wetzel County (West Virginia Quadrangle No. 12) (Equitable Statement No. 6, p. 6).

Equitable entered into its present supply contract with Kentucky West in 1977. According to Equitable, Kentucky West has been its most reliable supplier at the long run least cost (Equitable Statement No. 13, p. 17). Without the Kentucky West supply, Equitable would have had a supply deficiency of 20,000,000 Mcf in 1978 rather than the 990,000 Mcf curtailment it imposed on its customers (Equitable Exhibit V, Item No. 53.65(d)). In the event of future curtailment, Equitable expects Kentucky West to be more reliable than either Texas Eastern or Tennessee (Tr. 1073-1074; Equitable Exhibit 16I, Item No. 3). It should be noted here again that Kentucky West is a sister company to Equitable, each being owned by Equitable Resources, Inc.

Appalachian Supply represents Equitable's purchases from local independent producers located in both Pennsylvania and West Virginia. Historically, Equitable has sought to acquire the gas reserves developed by independent producers near to its gathering and transmission pipelines, thereby maximizing utilization of its facilities. Contracts covering the purchase of gas in Pennsylvania, for the most part, represent fixed price contracts with the purchase price being determined by gas vintage and the economic conditions under which the contracts were negotiated or the wells drilled and the quality of the gas purchased. These contracts represent long-term supply commitments, since they cover the purchase of gas for the life of the well or for a period of time estimated to permit recovery of most of the reserves of the well (Equitable Statement No. 6, pp. 12-13).

According to Equitable, the Appalachian supply obtained annually from independent producers in West Virginia is usually about three to five times greater in volume and is substantially more expensive than that ob-

tained from independent producers in Pennsylvania. Although the requirements vary, in general, the gas purchase agreements under which Equitable acquires its Appalachian supply from miscellaneous independent producers in West Virginia contain take or pay provisions which require Equitable to take or pay for a specified volume of gas (Equitable Statement No. 6, p. 14).

Equitable's New Appalachian Supply represents production from an area in southern West Virginia referred to by its developers as Hawk's Nest. Hawk's Nest is located at the southern most end of Equitable's gathering and transmission facilities. Equitable obtained the Hawk's Nest supply in early May 1978 when its system deliverability and gas supply were at a critically low level. The majority of this supply is purchased from two producers, Cabot Oil and Gas Corporation and Natural Resources Management. Gas produced by these producers is obtained under ten year contracts at NGPA Sections 102 and 108 prices. Upon expiration of the initial primary term, each contract continues from year to year thereafter upon the mutual agreement of the parties involved. Originally, Equitable obtained about 5½ million Mcf per year of supply from about 130 wells that are operated in the Hawk's Nest area.

The purchase agreements under which Equitable obtains this new Appalachian supply provide that Equitable will take or pay for 75% of daily deliverability as determined by a three day test (Equitable Statement No. 6, pp. 14-15). In its update to reflect known changes through April 30, 1985, Equitable reduced its projected annual Pennsylvania allocated purchases from Hawk's Nest to approximately 933,000 Dth to reflect the results of a new deliverability test and reduced the gas costs for the Hawk's Nest supply to reflect expected renegotiation of the price with the Hawk's Nest producers (Equitable Exhibit V-A).

Equitable controls approximately 395,000 acres of gas lands in Pennsylvania and West Virginia. Of this total acreage, approximately 50,000 are held for underground storage purposes. Of the remaining 345,000, approximately 275,000 have been drilled and are producing gas. Approximately 70,000 acres represent unoperated production acreage. Approximately 40 percent of this acreage is at present under farm-out agreements to independent producers.

Company production in Pennsylvania and West Virginia, before allocation to Pennsylvania service, amounted to 1,263 MMcf and 2,302 MMcf, respectively, in 1980 and to 1,061 MMcf and 2,057 MMcf, respectively, in 1984. Production is estimated at 1,072 MMcf in Pennsylvania and 2,028 MMcf in West Virginia (1,634 MMcf of which are allocated to Pennsylvania service) for the 12 months ending August 31, 1986.

A. *Proposed Adjustments*

Trial Staff and the OCA have proposed three main adjustments to the Company's projected gas costs during the period September 1, 1985 through August 31, 1986. One deals with the Company's purchases from its two Southwestern pipeline suppliers, another deals with the volumes acquired from the Hawk's Nest production area, and finally, an adjustment is proposed to the projected minimum bill payments from Equitable to Kentucky West.

(1) Tennessee-Texas Eastern Purchases

For the projected period, September 1, 1985-August 31, 1986, Equitable proposes to acquire 13,811 Mdth from Tennessee and 26,854 Mdth from Texas Eastern. The amounts projected from each are reductions below minimum bill volumes and are according to a pro rata reduction (Equitable Statement No. 13, p. 8; Tr. 44). Trial Staff and the OCA argue that it is contrary to a least

cost procurement policy for the Company to reduce its takes from Tennessee and Texas Eastern by the same 16 percent in view of the disparity in price between the commodity rate for gas from the Tennessee system and gas from the Texas Eastern system. At one time during the hearing, Tennessee's commodity rate was at $3.5388 per dth. Texas Eastern Gas was priced at $2.9932 per dth.

Trial Staff proposed that projected gas takes from Tennessee be decreased from the projected 13,811 dth to 7,766 Mdth and that Texas Eastern gas takes should be increased from 26,854 Mdth to 32,899 Mdth. When this adjustment is implemented, the payment of fixed costs pursuant to the Tennessee system minimum bill provisions are increased. However, the volumes from Texas Eastern will exceed minimum bill amounts and, therefore, $830,000 will be saved. The net savings to Equitable will be $2,992,000, exclusive of the $830,000 minimum bill payments to Texas Eastern (T.S. Statement RG-1, p. 7).

The Company argues that this adjustment is wrong. According to the Company, it is attempting to balance its current surplus supply situation consistent with the long term needs of its customers.

From 1980 until 1983, the company managed its supply surplus by selling gas off-system or turning back excess supply to the respective pipeline supplier employing a least cost strategy between the minimum bill and full contract volumes (Equitable Statement No. 13, p. 7). Under this strategy, the most expensive pipeline gas was turned back to its supplier first, and then the next most expensive and so on until any excess supply above minimum bill levels was eliminated (Equitable Statement No. 6, p. 17).

However, in 1983, its market eroded drastically due to the combination of a number of factors beyond Equita-

ble's control, including declining oil prices, continued effects of the economic recession, an unseasonably warm winter and conservation practices implemented by its customers. As a result, Equitable in 1983 found it necessary, for the first time, to purchase below minimum bill levels. As a consequence of the demand constraints, Equitable on June 30, 1983 (1) invoked the *force majeure* clause in the General Terms and Conditions of Texas Eastern's, Tennessee's and Kentucky West's FERC jurisdictional tariffs, (2) reduced purchases effective July 1, 1983 to levels below minimum bill volumes and (3) informed its suppliers that Equitable would pay only for gas taken. Excess gas below minimum bill levels was turned back to interstate pipeline suppliers on a pro rata basis (Equitable Statement No. 13, pp. 7-8).

Equitable states that pro rata reductions were initiated for three reasons (Equitable Statement No. 13, p. 8). It believed that the FERC Staff advocated that method; that pro rata reductions spread the risk of adverse consequences over all three FERC jurisdictional suppliers; and pro rata reduction methodology was specified in a proposed settlement agreement with Tennessee.

Over the next several years, Equitable projects a continued significant supply/demand imbalance. The imbalance or supply surplus is of sufficient magnitude that Equitable will be required to purchase below minimum bill levels from its FERC jurisdictional suppliers. To accommodate this supply surplus, Equitable believes the best policy would be to turn back excess supply below minimum bill levels on a pro rata basis.

Equitable argues that the Trial Staff and OCA adjustments would have it maximize its takes from Texas Eastern, which Equitable considers the supplier most likely to be in curtailment by 1995 (Tr. 1060). Such a policy, it believes, would jeopardize long run supply adequacy and reliability. Equitable argues that when gas distribu-

tion companies significantly reduce their takes from pipeline companies, the pipeline companies put these customers' long run supply at risk by petitioning the FERC to abandon their utility service obligations.

Equitable also argues that although excess supply is currently available, future shortages and curtailments are a distinct threat and in the past, such curtailments have been effectuated on the basis of historic takes. This adjustment could jeopardize, Equitable argues, long term supply.

In addition, Equitable argues, neither Trial Staff's nor the OCA's recommendations can be justified on a long term cost basis (Equitable Exhibit 16M-1, Item No. 2).

The record, however, does not support Equitable's position. First, it is clear that the utility decided to institute a pro rata reduction without any consideration of the commodity rates charged by each supplier (Tr. 44-45). In addition, the Tennessee settlement relied upon was approved by FERC conditioned upon the elimination of the pro rata requirement (Tr. 1168). Similarly, reliance on statements made by the FERC staff cannot justify establishing a pro rata reduction policy.

In this regard, the ALJ stated that the main reason for this policy appears to be spreading the risk of future adverse conditions over three FERC suppliers, and that to institute such a policy without consideration of its impact on today's ratepayers is contrary to the spirit of Act 74. We concur with the recommendation of the ALJ. There is no justification here for taking more higher priced gas than reasonable when lower priced gas is available.

Contrary to its assertions, Equitable has not shown that its exercise of discretion to pursue a least cost fuel procurement policy in the short term will impair its long term supply from Tennessee or any other interstate pipe-

line supplier. Furthermore, any possible curtailment refers to events ten years or more in the future (Tr. 1171- 1172). While a pro rata cutback policy might have some validity if there were signs of shortages appearing on the horizon, such is not the situation here.

The claim that Texas Eastern is an unreliable source of inexpensive gas is not supported by the record. At present, Texas Eastern enjoys the lowest commodity rate of any pipeline serving Pennsylvania. A major reason for Texas Eastern's commodity rate is the inclusion of significant volumes of Gulf Warranty gas in Texas Eastern's supply mix (Tr. 1219). But the record indicates that even if the cheaper gas of the Texas Eastern system could be subject to substantial increases when the Gulf Warranty gas source is depleted, the commodity rate would still be competitive, and perhaps lower than that of Kentucky West (Tr. 1219-1220).

It should be noted that Texas Eastern, by use of so-called "market out" provisions in its contracts with producers, has a hedge against an abrupt escalation in price. This protective contract device has already triggered a price reduction for Texas Eastern customers and is available to counteract the onset of unmarketable gas prices.

The record indicates that the possibility of curtailment on the Texas Eastern system is no more a factual probability than for the Tennessee or Kentucky West systems. The Texas Eastern pipeline is acquiring supplies in the Appalachian region, in contrast to the situation that existed during earlier curtailment periods. Trial Staff's adjustments appear to be the more reasonable of those proposed on this record and should be adopted. The projected purchases from Tennessee during this period should be reduced, replaced by additional purchases from Texas Eastern, thereby saving ratepayers some $2,992,-000.

(2) Hawk's Nest

Trial Staff and the OCA argue that Equitable has overstated the volumes that it will need to acquire from production known as Hawk's Nest. Hawk's Nest production is relatively expensive gas with a commodity rate estimated at $4.527 dth (T.S. Statement RG-1, p. 8). Equitable's contractual obligation is 75% of the daily capability. These parties contend that pursuant to a recent deliverability study (Equitable Exhibit 15, G-1, Item 2), the daily contractual entitlement should be reduced downward to 3,896 Mcf. The reduced takes from Hawk's Nest, they maintain, should be replaced with volumes from Equitable's lowest cost pipeline supplier, Texas Eastern. The OCA also recommends that the projected cost of the Hawk's Nest purchases be reduced based on the anticipated successful negotiation of price concessions from the Hawk's Nest producers. In its Update to Reflect Known Changes through April 30, 1985, Equitable reduced its projected Pennsylvania allocated purchases from Hawk's Nest to 933 MMcf reflecting the results of the new deliverability test and reduced the cost rate for these purchases to $3.50/Mcf reflecting a successful renegotiation of the cost rate with the Hawk's Nest producers (Equitable Exhibit No. V-A, Sheets 17 and 27).

(3) Kentucky West—Minimum Bill Payments

For the twelve months ending August 31, 1986, Equitable projects purchases of 15,527,000 dekatherms from Kentucky West. These purchases are below the Kentucky West minimum bill level and reflect Equitable's pro rata reduction strategy. Equitable's projected natural gas supply cost for the twelve months ending August 31, 1986, includes a claim for Equitable's estimated minimum bill liability to Kentucky West for gas not taken below minimum bill during that period. Trial Staff opposes the claim on the basis that the minimum bill payments are

not being made to Kentucky West and that Equitable has made no such payments in the past.

Equitable argues that such claims are reasonable and that since these payments will be made pursuant to terms approved by the FERC, the Commission has no jurisdiction to disallow this minimum bill payment.

The adjustment recommended by Trial Staff is adopted. The record here indicates no minimum bill cost incurrence (Tr. 150-151).

Furthermore, as Trial Staff points out, the fact that Equitable has accrued these minimum bill obligations pursuant to a FERC approved tariff is irrelevant to the question of whether there is a sufficient factual basis to conclude that they will be experienced in the Section 1307(f) collection year. The Company's claim should be reduced by $731,000.

The OCA would assume a reduction in Equitable's Kentucky West daily entitlements of some 40,000 to 45,000 Mcf. Equitable claims that the proposed reduction is 24,417 Mcf per day. Since negotiations are still underway, the ALJ concluded that it would be inappropriate to make such an adjustment at this time. We concur with this conclusion.

V. GAS COSTS INCURRED DURING THE PERIOD JULY 1, 1983 JUNE 30, 1984

Pursuant to Section 53.64(h)(2) of Title 52 of the Pennsylvania Code, 52 Pa. Code § 53.64(h)(2), Equitable filed a reconciliation plan for the treatment of over/undercollections during the period of transition from the current gas cost rate mechanism to the Section 1307(f) procedure. The updated plan covers actual over/undercollections for the period July 1984 through March 1985 and an estimate of over/undercollections for the period April 1 through December 31, 1985. As shown in Equi-

table Exhibit V-A, actual undercollection for the nine months ending March 31, 1985 totaled $16,794,960. For the balance of the period, Equitable estimates a total overcollection of $6,206,000. The result is a net undercollection for the eighteen months ending December 31, 1985 of $10,588,960.

Rather than recognizing the total undercollection in this Section 1307(f) filing, Equitable proposes to recognize only $5,300,000 of undercollections, or one-half of the projected amount. At the time of the next purchased gas cost adjustment to become effective September 1, 1986, the difference between the actual over/undercollections during the 18 months ended December 31, 1985 and the $5,300,000 used in 1985 will be utilized for the "E" factor. According to Equitable, this method will moderate the effects of the transition period on customer rates over a two-year period. The methodology proposed, but not the numbers used, is unopposed and is adopted by the Commission.

Both Trial Staff and the OCA allege that during the twelve months ending June 30, 1984, Equitable had available to it and did not make use of cheap company production. Trial Staff also alleges that during the twelve months ending June 1984, Equitable had available to it and did not use relatively low cost Pennsylvania and West Virginia local production. Trial Staff proposes adjustments to Equitable's reconciliation claim which assume that Equitable utilized company and/or local production in lieu of Kentucky West volumes during the period ending June 30, 1984.

Equitable first argues that these adjustments give Act 74 an impermissible retroactive effect.

Equitable argues that there is nothing in the Title of Act 74 which gives notice of retroactive application as required by Article III, Section 3 of the Pennsylvania Constitution.

As the OCA points out, however, the standards set forth by Act 74 present a new statutory authority for the Commission's use. However, as the Commission has set forth in its *Gas Cost Rate No. 6* Order (M-78050055F083), it has the authority to disallow the pass-through of excessive gas costs *even before Act 74 was established.* In *Pa. P.U.C. v. National Fuel Gas Distribution Corporation* (R-832469, March 22, 1985) the Commission disallowed the pass-through of excess gas costs incurred in early 1983 under the Gas Cost Rate mechanism in effect prior to the enactment of Act 74. The OCA argues that the Commission's authority to disallow unreasonable gas costs is not dependent upon the retroactive application of the provisions set forth in Act 74 and any such disallowance in this case is not limited by the powers provided by Act 74.

The Commission's *Gas Cost Rate No. 6* decision specifically stated (Order issued January 13, 1984, mimeo, pp. 7-8):

> Those utilities (today we deal with gas, but electric and steam utilities are no different) which use an automatic fuel cost adjustment tariff should be on notice that our procedures will remain unchanged. It is our intention to act on Gas Cost rate filings quickly. The ease and rapidity with which a GCR is acted on should not lull a utility into the mistaken reliance that *NFG* will protect it from the continuous scrutiny specified by our prior order and the tariffs under which these clauses are implemented. Until an appellate court holds that Section 1307 procedures do not permit this Commission to retroactively adjust fuel cost rates we will continue to operate on the assumption that we have the power to review prior Gas Cost Rates retrospectively and comprehensively. We will exercise our power of review for the purposes of determining not only the arithmetic accuracy of the fuel costs incurred and billed, but also

> the reasonableness of those charges. We deem it appropriate at this time to reaffirm our order of May 21, 1978 at this docket number and incorporate its terms by reference herein. *Re Gas Cost Rates*, Docket No. M-78050055, May 23, 1978. 52 Pa. P.U.C. 217. (We note that we are concurrently considering the results of our GCR No. 5 Investigation at Docket Nos. M-78050055 and D-79S00192. However, we expect our final order on GCR No. 5 to have no real impact on the principles reaffirmed today.) We not only reserve the right, but also specificially condition the granting of approval of GCR No. 6 (or any automatic fuel cost adjustment tariff) on the ability or power of this Commission to retroactively investgate, audit and adjust the reasonableness of the rates set herein as contemplated by the express wording of subsection 1307(e)(2).

It would appear that no retroactive application of law issue arises in this case as a result of the application of Act 74. The Commission has advised Equitable of its power to so adjust rates when it approved GCR No. 6. These adjustments to Equitable's gas costs do not go back prior to the beginning of GCR No. 6. Equitable was given notice of the Commission's intention to review retrospectively its gas costs to be incurred during the GCR No. 6 period.

Equitable also argues that the Commission previously found Equitable's gas supply management to be prudent in its GCR No. 5 Order (M-78050055; D-79500 192, F. GCR5, Order entered March 16, 1984), and that any adjustment now would be improper. However, as Trial Staff points out, the Commission at page 8 of its GCR No. 5 Order, expressly held that all fuel revenues and expenses, whether in the GCR or in base rates, are subject to review within the Commission's GCR procedures and are not Commission-made rates. In addition, the

issues raised by Trial Staff and the OCA here were not actually litigated in GCR No. 5.

This Commission has inherent authority to disallow the pass-through of imprudently incurred and excessive gas costs. In GCR No. 6 the Commission stated that it may retroactively investigate, audit and adjust the reasonableness of rates set in a GCR proceeding. The authority to adjust retroactively the reasonableness of a rate is premised on Sections 1301 and 1307(e) of the Public Utility Code, 66 Pa. C.S. §§ 1301, 1307(e).

Section 1301 of the Public Utility Code provides, *inter alia*, that every rate made, demanded or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable. Section 1307(e)(3) provides that absent good reason being shown to the contrary, the Commission shall, within 60 days following such hearing, by order, direct each such public utility to, over an appropriate 12 month period, refund to its patrons an amount equal to that by which its revenues received pursuant to such automatic adjustment clause exceeded the amount of such expense or class of expenses, or recover from its patrons an amount equal to that by which such expense or class of expenses exceeded the revenues received pursuant to such automatic adjustment clause.

At the time it issued the GCR-No. 6 Order, the Commission acknowledged that it was concurrently considering the results of GCR-No. 5. The Commission noted:

> . . . However, we expect our final order on GCR-No. 5 to have no real impact on the principles reaffirmed today.

GCRNo. 6, p. 8.

The rates established under Section 1307 and the GCR mechanism are procedurally and legally distinct from those pursuant to Section 1308. Rates under Section 1307

are put into effect with none of the indicia of antecedent review and finality that attaches to a Section 1308 rate. The Order in Equitable's GCR-No. 5 proceeding was entered March 16, 1984. The date of entry precedes the end period of inquiry for the adjustments proposed here which are based upon the period July 1983-June 1984. Therefore, to give any conclusive effect to the rate established in GCR-No. 5 would be contrary to the scheme of regulation contemplated by Section 1307. That scheme of regulation expressly contemplates a 12-month period wherein the Commission may exercise a more studied procedural opportunity to determine the reasonableness of costs incurred by a utility.

Finally, the Commission has expressly rejected all arguments which would limit its authority to review rates established pursuant to a GCR mechanism to an arithmetical "true-up" endeavor. *National Fuel Gas v. Pennsylvania Public Utility Commission*, 76 Pa. Commonwealth Ct. 102, 464 A.2d 564 (1983).

We now turn to the actual adjustments proposed by the parties.

Both Trial Staff and the OCA allege that during the twelve months ending June 30, 1984, Equitable had available to it and did not make use of company production. Trial Staff also alleges that during the twelve months ending June 1984, Equitable had available to it and did not use relatively low cost Pennsylvania and West Virginia local production. Trial Staff and the Consumer Advocate propose adjustments to Equitable's reconciliation claim which assume that Equitable utilized company and/or local production in lieu of Kentucky West volumes during the period ending June 30, 1984.

According to Equitable, the Company decided prior to the beginning of the 1983 summer period to reduce takes from its independent producers in order to reduce the quantity of excess gas supply on its system. Equitable's

agreements with its independent local producers are on a life-of-the-well basis and, unlike pipeline supply, any gas not taken remains available to Equitable in the future. The same is true with respect to company production. In contrast, any gas not taken from a pipeline supplier is lost to Equitable, even those volumes for which Equitable pays minimum bill deficiencies (Equitable Statement No. 13, p. 9).

According to Equitable, the terms of the various purchase agreements under which Equitable purchases gas from independent producers allow the Company to discontinue completely or reduce takes during the summer period. As a matter of policy, company production is shut-in any time a majority of the production of local independent producers is also shut-in. Such equal treatment, Equitable states, is accorded independent producers in the interest of fairness and equality to prevent indiscriminate drainage of producer gas reserves. When wells of local independent producers were ultimately shut-in during the summer of 1983, company owned wells were also shut-in. Aside from the fairness of this policy in terms of preventing drainage of producer gas reserves, such shut-in of company production prevents costly and lengthy legal action over inequitable drainage being initiated by independent producers (Equitable Statement No. 13, p. 9).

The OCA also argues that during this period, Equitable should have taken more gas from Texas Eastern in place of gas actually taken from Kentucky West (OCA Statement 1, pp. 42-43).

Trial Staff argues that during the period July 1983 through June 1984, Equitable had available to it 1,369,339 Mcf of company owned production. This capacity from company owned wells represented a less expensive source of gas, reasonably available to Equitable, that was not taken. Trial Staff notes that during this time, Equitable

increased its acquisitions from its corporate relative, Kentucky West (T.S. Statement RG-1, Appendix G).

In view of the fact that 1,369,339 Mcf of a cheaper gas source was available, Trial Staff proposes that these volumes displace volumes obtained from Kentucky West. Displacement of these volumes, according to Trial Staff, would recognize this Commission's inherent authority to disallow the pass through of imprudently incurred and excessive costs. If Equitable had foregone the purchase of volumes from its corporate relative which were not needed for its system supply, a reduction of $5,958,829 in its claimed gas purchase costs would have been realized. Consequently, according to Trial Staff, Equitable's claim for gas purchase costs should be reduced by that amount.

Trial Staff argues that Equitable also cut back its acquisition of Pennsylvania and West Virginia Miscellaneous (or local) production. During the period July 1983-June 1984, approximately 2,400,031 Mcf of gas from nonaffiliated sources was available but not taken (T.S. Statement RG-1, Appendix E). Trial Staff proposes that Kentucky West gas taken during this period should be displaced with these less expensive volumes of Miscellaneous Purchases. The result proposed is a reduction of $5,898,378 of Equitable's claimed gas purchase expenses.

Equitable argues that these adjustments are wrong. First, as noted above, it contends that gas not taken from company and local production remains for use at a future time. Any gas not taken from a pipeline supplier is lost to Equitable (Equitable St. No. 13, p. 9).

Trial Staff points out that, theoretically, any gas not taken from a pipeline supplier is either sold or stored elsewhere in interstate commerce. Equitable, by virtue of its contractual entitlement with any pipeline supplier, has a right to receive quantities up to the maximum per-

mitted by the contract. When Equitable pays any pipeline supplier a minimum bill payment, it has compensated that pipeline as fully as is permitted by FERC regulation and federal law. Consequently, any supply needed from that pipeline supplier in a future period will be according to the contract volumes agreed to.

Trial Staff is correct. Volumes are not "lost" in any sense. A pipeline supplier has a duty to provide Equitable with the gas to which it is contractually entitled, and such an obligation would be excused only for cause, such as curtailment or a shortage.

Equitable also argues that its production takes resulted in lower net costs given its minimum commodity bill liability from its pipeline suppliers. Additionally, it argues that in order to conserve local production and local supplies of gas, it was necessary to shut-in each of these sources in order to conserve this gas for further use and that both local production and local supplies must be shut-in at the same time in order to avoid any legal liability on the part of Equitable for inequitable drainage practices.

The OCA points out that Equitable has never demonstrated on this record that the shutting-in of local production and local purchases of gas was cost justified in relation to the minimum commodity bill liability which it would have incurred had it continued to take local production and local purchases of gas supply while cutting back on its pipeline takes.

The OCA contends that Equitable has not met its burden of proof in demonstrating that the shutting-in of its own Equitable production and local purchases of gas was consistent with a least cost purchasing policy.

The OCA also disputes Equitable's assertion that it was required to shut-in both of its own production and local gas producers in order to avoid the cost of local purchases. Even if shutting-in local purchases were re-

quired under a least cost purchasing policy, the OCA argues, there was no justification for also shutting-in Equitable's own local production which represents a zero cost source of supply from the ratemaking perspective.

There would appear to be no basis for Equitable's argument that both Equitable production and local purchases must be shut-in equally in order to avoid costly legal action over inequitable drainage. While such a requirement is mandated in unitized fields,[1] fields in West Virginia and Pennsylvania do not have such a restriction (Tr. 914). Equitable has not produced any statute or regulation forbiding an unequal shut-in policy (Tr. 1111). Indeed, in certain instances where the contracts required Equitable to continue taking from local suppliers, these wells were allowed to continue operating while Equitable's own production was shut-in (Tr. 180182). Just as the well of a local supplier may be drained by Equitable's production, so may Equitable's own production be drained by other suppliers (Tr. 1108).

In short, Equitable was not required to shut-in both its own local production and local suppliers based on a least cost purchasing policy. Even if such action would have been justified with regard to local suppliers, Equitable was not required to also shut-in its own local production which represented a zero cost source of supply to the ratepayer. In fact, some local suppliers operating in the same field were not shut-in. This resulted in the drainage of Equitable's own production. Upon this basis, Equitable unfairly denied to its ratepayers its own local production which may have also been lost through field drainage.

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[1] According to OCA witness Lelash (Tr. 1014), "unitized is a word of art that is applied to the production agreements between various producers within a field where drainage is a problem and it's an agreement that protects the interests of the individuals within that field, particularly where there are different takes from certain pipelines that are not within the control of the producer."

Equitable during this period made a conscious decision to cut back its takes from less expensive gas sources and chose to continue to purchase more expensive gas from Kentucky West. From July 1983 through June 1984, the price for Kentucky West gas has ranged from $4.19/Mcf to $4.92/Mcf when substantially cheaper gas was available from Equitable's own production. Pennsylvania ratepayers should not be required to continue to pay Kentucky West's prices when available company production and miscellaneous purchases could have produced approximately $5,958,289 in gas cost savings to Equitable's ratepayers.

We agree with the ALJ that consistent with the requirements of the Public Utility Law, the adjustments proposed by Trial Staff should be made.

The record also shows that during this period Equitable cut back its acquisition of Pennsylvania and West Virginia Miscellaneous (or local) production. During the period July 1983-June 1984, approximately 2,400,031 Mcf of gas from nonaffiliated sources was available but not taken (T.S. Statement RG-1, Appendix E). Trial Staff proposed another adjustment based upon the failure of Equitable to avail itself of these inexpensive local purchases. According to Trial Staff, expensive Kentucky West gas taken during this period should be displaced with these less expensive volumes of Miscellaneous Purchases. The result proposed is a reduction of $5,898,378 of Equitable's claimed gas purchase expenses. For the reasons stated above, this adjustment should be adopted.

VI. GAS PURCHASES DURING THE PERIOD JUNE 1984-DECEMBER 1984

Trial Staff proposes a reduction of $3,199,580 in the company's claim for purchased gas costs during the period June 1984 to December 1984. According to Trial

Staff, the record here shows that approximately 1,715,966 Mcf of local gas and 424,844 Mcf of company production was available but not taken during this period. Had this gas been taken, and not the more expensive gas obtained from Kentucky West, purchased gas costs to be borne by the ratepayers would have been reduced by approximately $3.2 million.

During the hearing, a dispute arose over whether or not Equitable shut-in its own production during calendar year 1984 (Equitable Exh. GC-3; T.S. Statement RG-No. 3; Equitable Statement 13, pp. 22-23). This dispute cannot be resolved on this record. It is clear, however, that production dramatically declined during this period.

Act 74 requires, in part, that the Commission determine that a gas distribution company, purchasing all or part of its gas supplies from an affiliated interest, has not withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy. Such a finding could not be made here since it is clear that for whatever reason, Equitable has withheld company production and has not taken miscellaneous production which could have substantially reduced gas costs to its ratepayers. Trial Staff's adjustment should be made.

VII. FEDERAL PREEMPTION

Equitable, in its Brief, argues that the Commission is barred by the doctrine of federal preemption from making the type of adjustments proposed here by Trial Staff and the OCA.

According to the utility, these adjustments would reduce volumes or prices paid by Equitable to FERC jurisdictional suppliers and impermissibly contradict those FERC approved tariffs, thus standing as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress in enacting the Natural Gas Policy Act of 1978.

The OCA, however, correctly points out in its Brief that this Commission is not precluded from examining the reasonableness of Equitable's incurred gas costs which it seeks to pass along to its ratepayers. A similar FERC preemption argument was made by *Pike County Light and Power* at R-821857. This argument was rejected by the Commission. Specifically, the Commission refused Pike's proposal to pass through to the ratepayers the full purchased power cost claimed by Pike under its FERC regulated contract with its corporate parent, Orange and Rockland. The Commonwealth Court approved this type of expense disallowance in that case stating:

> The FERC focuses on Orange and Rockland to determine whether it is just and reasonable *for that Company to charge* a particular rate, that makes no determination whether it is just and reasonable *for Pike to incur* such a rate as an expense. The PUC, on the other hand, has no jurisdiction to analyze Orange and Rockland's cost of service data and makes no determination as to the reasonableness for Orange and Rockland to charge its rates. The PUC focuses on Pike and its cost of service data to determine whether it is reasonable for Pike to incur such costs in light of available alternatives. So while the FERC determines whether it is against the public interest to charge a particular rate in light of its cost, the PUC determines it is against the public interest for Pike to pay a particular price in light of its alternative. The regulatory functions of the FERC and the PUC thus do not overlap, and there is nothing in the federal legislation which preempts the PUC's authority to determine the reasonableness of a utility company's claimed expenses.

Pike County Light and Power Company v. Pa. P.U.C., 77 Pa. Comw. 268, 274-275, 465 A.2d 735, 738 (1983). Petition for Allowance of Appeal denied, *Pike County Power and Light v. Pa. P.U.C.*, No. 628 E. D. Allocatur

Docket 1983, December 19, 1983. It is clear that the *Pike* case clearly establishes this Commission's authority to examine Equitable's purchased gas costs incurred and deny the collection of any excessive affiliated costs incurred in light of other available alternatives.

In addition, it must be recognized that this Commission has authority to require regulated distribution utilities to purchase the most economical sources of gas supply available. Act 74 recognizes such authority and specifically provides that:

> The fact that a contract or rate has been approved by a Federal regulatory agency for interstate ratemaking purposes shall not, in and of itself, be adequate to satisfy the utility's burden of proof that gas prices and volumes associated with such contract or rate are just and reasonable for purposes of this section.

66 Pa. C.S. § 1318(d). Even though such a regulatory action would also affect the purchases by these utilities of FERC regulated pipeline gas, the local procurement functions of distribution utilities clearly fall within this Commission's jurisdiction.

VIII. ACT 74 FINDINGS

As noted earlier, Act 74 requires the Commission to make specific findings with respect to the reasonableness of a utility's gas purchases. We will discuss each required finding *seriatim*.

(1) The utility has fully and vigorously represented the interests of its ratepayers in proceedings *before the Federal Energy Regulatory Commission.*

Equitable states that it has intervened in pipeline supplier rate hearings and has participated at prehearing conferences and at the rate hearings themselves. The Company has also participated in the activities of the

United Distribution Companies (UDC) through its membership on the Executive Committee of that organization. UDC is an ad hoc group presently comprised of 31 distribution companies engaged in providing gas utility service to the public at retail. UDC was formed in 1969 as a result of the concern over the emerging national gas shortage to present the position of the distribution companies on gas issues before the FERC and the Congress (Equitable Statement No. 6, p. 21; Equitable Exhibit 15F-2, Item No. 8).

In addition, Equitable, through its membership in the American Gas Association (AGA), has opposed the decontrol of old gas and the accelerated decontrol of other categories of gas under the NGPA (Equitable Statement No. 6, pp. 21-22).

Equitable states that the Company's participation in FERC proceedings is designed to be cost effective. Thus, Equitable does not attempt to restate issues already raised by FERC Staff or other intervenors provided the company is reasonably certain that the matter will be resolved in a satisfactory manner (Equitable Statement No. 6-1, p. 4).

Attachment A to Equitable Statement No. 6-1 contains an expensive explanation of the Company's participation in the FERC proceedings of each of its FERC jurisdictional suppliers.

The Company admits, however, that it does not participate as actively in Kentucky West FERC proceedings as it does in those involving Texas Eastern and Tennessee.

Equitable believes that any greater participation is not required and would not be cost effective because the interests of the Company's customers are fully represented by other participants, particularly Columbia Gas Transmission Corporation, the Kentucky Public Service Commission and various municipalities, and because Equita-

ble is familiar with the factual bases underlying Kentucky West's claims.

It is this lack of active participation in its affiliated supplier's proceedings which Trial Staff and the OCA criticize. Trial Staff notes that Equitable witness J. J. Ayres, Vice-President—Corporate Planning for Equitable Resources, Inc., is in a supervisory position to Equitable witness T. L. Cooke, Director of Energy Planning for Equitable Gas Company. Mr. Ayres is also a member of Kentucky West's Board of Directors.

It should be noted that only Equitable and Columbia Gas Transmission Corporation purchase from Kentucky West under a PLS-1 tariff. As Trial Staff points out, the volumes purchased by Equitable and Columbia offer no basis for comparison. Equitable is by far the largest purchaser of gas from Kentucky West. For the PGA period ending October of 1982, Equitable represented 72.3% of the total sales made by Kentucky West.

The assertion by Equitable that the interests of the Company's customers are fully represented by other participants, particularly Columbia Gas Transmission Corporation, the Kentucky Public Service Commission and various municipalities, is not well founded. Equitable is a wholesale customer representing over 70% of the volume sold by Kentucky West. Columbia has a substantially smaller interest in litigating Kentucky West matters. The Kentucky Public Service Commission cannot be said to have a direct interest in litigating matters involving just and reasonable rates for Pennsylvania ratepayers. Most importantly, the language of Act 74 at 66 Pa. C.S. § 1317(a)(1) imposes an obligation upon this Commission to make findings with respect to the utility's participation in rate proceedings before FERC.

The ALJ stated that the term "vigorous representation" has not been defined by the Commission, and that it would be unfair, therefore, to disallow Equitable's Sec-

tion 1307(f) rate because of its past actions. However, Equitable's ratepayers have the right to expect the utility to represent in an effective manner their interests before the FERC in proceedings involving all of Equitable's pipeline suppliers. A serious question arises as to whether such representation can take place in view of Equitable's present corporate structure. Under these circumstances, Trial Staff's proposal that the Company obtain independent representation of its interest by legal counsel and technical support staff wholly separate from Kentucky West has merit and should be adopted. Trial Staff's proposal in this regard is mandated by the term "vigorous representation" as contained in Act 74.

(2) The utility has taken all prudent steps necessary to negotiate favorable gas supply contracts and to relieve the utility from terms in existing contracts with its gas suppliers which are or may be adverse to the interests of the utility's ratepayers.

Equitable states that rising supply prices and the current short term gas supply surplus have made it necessary for it to challenge virtually every pipeline supply contract to which the Company is a party. Equitable, on June 30, 1983, invoked the *force majeure* clause in the General Terms and Conditions of Texas Eastern's, Tennessee's and Kentucky West's FERC jurisdictional tariffs, reduced purchases effective July 1, 1983 to volumes below minimum bill levels and told the suppliers that Equitable would pay only for gas taken.

Equitable has refused to make any minimum bill payments prior to FERC approval of stipulations and agreements with the pipeline suppliers. Only after such approval did Equitable make minimum bill payments to Texas Eastern and Tennessee (Equitable Statement No. 6, pp. 31-32; Tr. 1103-1104).

Equitable notes that it has not yet made any minimum bill payments to Kentucky West. Over the last two years,

Equitable has been pursuing settlement discussions with Kentucky West in an attempt to lessen the monetary burden upon Equitable and its ratepayers of any minimum bill payment to Kentucky West. Early in 1985, all issues were agreed to and were reduced to writing. The stipulation and agreement is presently being reviewed by both Equitable and Kentucky West and Equitable expects that the settlement will be submitted to the FERC for approval very soon. Under the terms and conditions of the proposed settlement, Equitable would purchase an additional 473,555 dekatherms at an average cost of $3.1843/DTH. The stipulation and agreement resolves all issues between Equitable and Kentucky West concerning the monthly minimum commodity bill provision of Kentucky West's Rate Schedule PLS-1 for the period covered by the stipulation. In content, the settlement is identical to the stipulation and agreement entered into between Columbia Gas Transmission Corporation and Kentucky West on March 22, 1984, which has been approved by the FERC (Equitable Statement No. 13, p. 20).

Equitable has also volunteered to reduce its contractual entitlements with Tennessee and Kentucky West. Initially, Equitable also contemplated reducing its contractual entitlements with Texas Eastern and to that end became involved in a proceeding at FERC Docket CP84-429 involving a proposed realignment of Texas Eastern contract entitlements. The Company ultimately decided to maintain its present entitlement with Texas Eastern because Texas Eastern is presently Equitable's lowest-cost source of southwest pipeline gas and, instead, to increase its reduction to its Kentucky West entitlement (Equitable Exhibit No. V, Item 53.64(b)(1)(i); Equitable Statement No. 6, p. 20).

In response to Equitable's request, Tennessee expressed a willingness to reduce contractual entitlements and has implemented a program subject to FERC approval at

FERC Docket No. CP84-441, whereby reductions in entitlements will be shifted to other customers that want additional supply (Equitable Statement No. 6, p. 20). Equitable's projected natural gas supply purchases for the twelve months ending August 31, 1986, reflect a reduction in Tennessee daily entitlements from 77,760 Dth to 65,325 Dth.

Kentucky West, however, indicated that any reduction in entitlements would be conditioned on Kentucky West being able to find other markets for the gas. To date, Kentucky West has not finalized negotiations with an alternative buyer for the up to 28,980 dekatherms of gas per day by which Equitable has requested that its contractual entitlement be reduced (Equitable Exhibit 16M-1, Item No. 14).

According to Equitable, Kentucky West is currently actively involved in developing a market for the gas that Equitable wishes to permanently release. It is unlikely that sales to any prospective buyer will occur before November 1986.

In addition to challenging the gas supply contracts of interstate pipeline suppliers, Equitable has also challenged certain pricing terms in contracts between Equitable and independent local gas producers. Equitable states that when the NGPA was enacted in 1978, a dispute arose between the Independent Oil & Gas Association of West Virginia (IOGA), a producer group, and Equitable over whether the area rate clauses in two FERC approved settlement agreements with IOGA at FERC Docket Nos. R174-188 and R175-21 authorized the IOGA producers to collect NGPA ceiling prices. Equitable has strongly resisted paying NGPA ceiling prices under the prior settlement agreements.

Finally, as previously indicated, Equitable has challenged and successfully renegotiated the contract terms of its Hawk's Nest supply. Reflected in Equitable's up-

dated projected natural gas supply purchases for the twelve months ending August 31, 1986, is a reduction of 700 MMcf in purchases from Hawk's Nest and a $1.027/Dth reduction in the cost of Hawk's Nest supply recently negotiated with the Hawk's Nest producers (Equitable Exhibit No. V-A, p. 1).

Trial Staff argues that Equitable has not met its burden established by this provision of the statute. Specifically, it points to Equitable's proposed reduction of its total daily entitlements with Kentucky West. Equitable, because of its oversupply system, is not able to physically take those volumes. However, Equitable is required to pay the fixed cost portion of minimum bill liability on these volumes (Tr. 36-39). Because of the affiliated relationship between Equitable and Kentucky West, Trial Staff claims that no armslength negotiations are going on. Given the dual responsibilities of Mr. Ayres, it argues, it is doubtful whether any meaningful negotiations could occur under the present corporate structure (Tr. 1207-1208). Trial Staff requests that review of the results of these negotiations be made subject to review in the next Section 1307(f) filing.

Equitable has sustained its burden here. It is clear, however, that the Equitable-Kentucky West negotiations must be reviewed in the Company's next filing.

(3) The utility has taken all prudent steps necessary to obtain lower cost gas supplies on both short-term and long-term bases both within and outside the Commonwealth, including the use of gas transportation arrangements with pipelines and other distribution companies.

Equitable states that it is continuing to seek new sources of supply at the lowest possible cost even though it is experiencing a short term supply surplus. The Company's intent in attempting to acquire gas from new

sources is to provide for additional supply to replace volumes of declining, existing purchases in order to maintain the balanced supply mix which Equitable considers so important. To the extent that this gas is purchased in a period of excess supply, Equitable intends to reduce its purchases of more expensive local supply (Equitable Statement No. 6-1, pp. 2-3).

In November 1982, and again in May and September 1984, Equitable notified all Appalachian producers from whom it purchases gas that Equitable would like to purchase quantities of new gas under the NGPA Section 103(b)(1) ceiling price. Equitable also placed ads in the major newspapers in every county in which it operates in West Virginia. In addition, Equitable placed ads in two trade publications, *The Oil & Gas Journal* and *The Northeast Oil Reporter*. This potential source of new gas purchases was intended to replace existing purchases from wells from which production was so low as to make their gas acquisition costs higher than the price of new NGPA Section 103 gas (Equitable Statement No. 6, p. 22).

According to Equitable, its efforts have been disappointing. There were only 51 inquiries resulting in only 16 contracts. For the eighteen months following March 1, 1985, Equitable plans to continue its efforts to obtain local production by advertising in major newspapers in the counties in which it operates, by advertising in trade journals and by making its gas acquisition policy known at producer meetings (Equitable Exhibit 15F-3, Item No. 12).

In addition to its attempts to solicit low cost supply, Equitable received the following supply offers, all of which were rejected for the reasons indicated:

Company	Date	Estimated Delivered Cost	Reason Rejected
Texas Gas Corporation	08/19/84	$4.25/Mcf	(A)
Producers Gas Company	09/10/84	4.20/Mcf	(A)
Martin Energy Company	10/03/84	4.36/Mcf	(A)
Hardson Gas System, Inc.	02/08/85	3.94/Mcf	(B)
Northern Natural Gas Company	06/08/84	4.37/Mcf	(A)
Hydro-Carbon Energies	06/26/84	3.62/Mcf	(C)
Ten-A-Coal Company	10/08/84	3.69/Mcf	(C)

(A) Tariff provisions of Equitable's existing long-term supply, Equitable's supply surplus, and cost of proposed supply too high.

(B) Equitable's supply surplus, cost of proposed supply too high, and limited Term availability.

(C) Equitable capacity restriction.

Equitable's projected gas cost is $3.9704/Mcf. The Texas Gas Corporation, Producers Gas Company, Martin Energy Company and Northern National Gas Company offers at $4.25/Mcf, $4.20/Mcf, $4.36/Mcf and $4.37/Mcf cannot be considered relatively low priced gas (Equitable Exhibit V-A). Equitable states that it will turn gas away that would cost more than present supply. The Hardson Gas System, Inc. offer was limited to one year and thus would not have furthered Equitable's efforts to acquire long-term reserves for the future. Hydro-Carbon Energies and Ten-A-Coal Company proposed to drill at sites where Equitable's nearest lines did not have sufficient capacity to move the gas from the well head (Equitable Statement No. 6-1, p. 3; Exhibit 16G-3 Item No. 15).

Equitable has met its burden here.

(4) The utility has not withheld from the market or caused to be withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

Equitable contends that it is not withholding or causing to be withheld from the market any gas supplies

which should be utilized as part of a least cost fuel procurement policy. The record indicates, however, that for the periods July 1983 to June 1984 and July 1984 to December 1984, Equitable did not take advantage of company production and local production that was available at lower cost than supplies which were used.

For the period September 1985 to August 1986, Equitable's gas supply array, as projected, would not result in a least cost fuel procurement policy.

The adjustments adopted herein, as proposed by Trial Staff, would result in meeting the burden imposed by statute.

(5) That the utility has fully and vigorously attempted to obtain less costly gas supplies on both short-term and long-term bases from nonaffiliated interests.

For the twelve months ending August 31, 1986, Equitable estimates that approximately 78% of its natural gas supply will be obtained from nonaffiliated interests with only 22% of its natural gas supply obtained from its affiliate, Kentucky West. For this period, Equitable projects a commodity cost rate for Kentucky West no higher than $3.5977 per Dth (Equitable Exhibit V-A, Sheet 26) which is equivalent to an incremental acquisition cost into Equitable's high pressure pipeline system of $3.75/Mcf.

As noted above, the Company has announced to all Appalachian producers from which it purchases gas that Equitable would like to purchase quantities of new gas under NGPA Section 103(b)(1) ceiling prices and has also placed ads in the major newspapers in every county in which it operates in West Virginia. In addition, Equitable also placed ads in two trade publications, *The Oil & Gas Journal* and *The Northeast Oil Reporter*. None of the potential supply sources to which these solicitations were aimed are Equitable affiliates.

Equitable offered to pay a well head price of approximately $3.70 per Mcf, which because of the need to transport this gas is equivalent to an incremental acquisition cost into Equitable's high pressure pipeline system of at least $4.20/Mcf, or about $0.45 /Mcf more than the projected cost of Kentucky West supply. At this price there were only 51 inquiries, resulting in only 16 contracts.

Additionally, although Equitable received non-affiliated supply offers from Texas Gas Corporation, Producers Gas Company, Martin Energy Company, Hardson Gas System, Inc., Northern Natural Gas Company, Hydro-Carbon Energies and Ten-A-Coal Company, none of the offers were at a delivered price into Equitable's distribution system less than the projected incremental acquisition cost of Kentucky West gas for the twelve months ending August 31, 1986.

Equitable has met its burden here.

(6) That each contract for the purchase of gas from its affiliated interest is consistent with a least cost fuel procurement policy.

In 1977, Equitable entered into a 20-year contract with Kentucky West at FERC approved Tariff Rate Schedule PLS-1 pursuant to which Equitable may purchase a maximum volume from Kentucky West of 71,013 dekatherms per day. When the contract was signed in 1977, Kentucky West was the lowest cost supplier of Equitable's three FERC jurisdictional suppliers (Equitable Exhibit No. V, Item V-3.65(d); Equitable Statement No. 6-1, p. 4). There is no question that the decision to enter into the Kentucky West contract was a reasonable and prudent one on the part of Equitable.

Kentucky West continued to be Equitable's lowest cost FERC jurisdictional supplier until October 1982. Subsequently, the cost of Kentucky West gas was authorized to rise to NGPA levels as allowed by the decision of the

United States Supreme Court in *New York Public Service Commission v. Mid-Louisiana Gas Company*, —— U.S. ——, 103 S. Ct. 3024, 77 L. Ed. 2d 668, 53 P.U.R. 4th 175 (1983).

While Equitable expects Kentucky West's rates to be more competitive in the future, one should remember the reason for the recent escalation in Kentucky West's gas prices.[2] The *Mid-Louisiana* decision referred to above determined that an interaffiliate sale of gas qualified for NGPA "ceiling prices" just as if the sale were being made to an independent third party. As a result, Kentucky West was no longer compelled to pay relatively low cost of service prices for its affiliate gas production, but could pay NGPA ceiling prices instead. Without any increase in Kentucky West's cost of affiliated production, these producers were legally able to charge much higher prices to its affiliate purchaser, Kentucky West.

Equitable, in its 1983 Annual Report to shareholders, noted that the *Mid-Louisiana* decision resulted in an increase to Kentucky West revenues of about $44 million in 1983 (Equitable Exhibit 16-0, pp. 2 & 6). Equitable reported that its 55% increase in 1983 earnings over 1982 levels resulted mainly from this decision. A 44% increase in earnings for 1984 over 1983 was also related to this decision (Equitable Exhibit 16-0, p. 2).

Although *Mid-Louisiana* allowed Equitable to raise Kentucky West's affiliated cost of gas to NGPA ceiling levels, this price change was not required by law. Equitable's corporate parent, Equitable Resources, by raising Kentucky West's rates but not allowing Equitable to pursue a least cost purchasing policy, effectively allowed Equitable to become the depository for Kentucky West's unmarketable gas.

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[2] Kentucky West's PGA went from $1.97/Mcf to over $4.91/Mcf in less than one year (T.S. Statement RG-1, p. 5).

Recently, with a relatively high cost from Kentucky West and a short-term excess supply of natural gas, Equitable responded by: (1) volunteering to reduce its contractual entitlement with Kentucky West and (2) reducing its takes from Kentucky West to the bare minimum required to retain the Kentucky West supply. According to the Company, Kentucky West is sympathetic to Equitable's request to reduce its entitlement by up to 28,980 dekatherms per day and is willing to revise its contract provided that an alternative market for the gas can be located. It should be noted, however, that Equitable's original filing here refers to a reduction of some 40,000-45,000 dekatherms per day.

It seems clear that a revision in this contract is necessary. In view of the fact that some movement is underway to align this contract more closely with Equitable's demand, we are not prepared at this time to state that the Company has not established this burden. Resolution of this matter should be accomplished by the next Section 1307(f) filing.

(7) That neither the utility nor its affiliated interest has withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

This finding duplicates that required by Item 4 above. The same conclusion and recommendation set forth there applies here also.

IX. MISCELLANEOUS

The OCA has proposed several other adjustments which shall be considered here. First, the OCA contends that if its revisions to the Company's gas cost claims for the historic 1983-1984 and 1984-1985 periods are adopted, which would result in hypothetical overcollections, the Company should be required to pay interest on these

hypothetical amounts. Using 12% as the appropriate interest rate, this would amount to $1,488,000.

The ALJ recommended that Trial Staff's adjustments be adopted which do not include interest on any hypothetical overcollections. The ALJ recommended that no interest be allowed. We concur with this recommendation.

During this period, Equitable actually experienced net undercollections on which it earned no return. There have been no overcollections as to which Section 1307(e) procedures would require interest payments.

The OCA also requests that issues relating to lost and unaccounted for gas, company use gas and the FERC's Gas Research Institute (GRI) surcharge be examined in base rate proceedings. Trial Staff makes no similar proposal. Equitable argues that the OCA's proposals should be rejected.

The Company's opposition is well-founded. First of all, lost and unaccounted for gas, company use gas and the GRI surcharge are included in the Purchased Gas Adjustments of all Pennsylvania gas distribution utilities. The OCA's proposals are more appropriate for consideration in a generic proceeding. It would be unfair and inequitable to deny Equitable recovery of these legitimately incurred costs in this Section 1307(f) proceeding, while permitting other Pennsylvania gas utilities to recover them.

Secondly, other than a proposed adjustment for unaccounted for gas,[3] the OCA has proposed no adjustments with respect to these items in the Equitable base rate proceeding at R-842769. Thus, there is no reason to post-

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[3] The OCA's position is that the claim for unaccounted for gas be limited to 5%. Equitable points out, however, that its unaccounted for gas claim is only 4.29%, well within the 5% limit proposed by the Consumer Advocate (Equitable Statement No. 6-2).

pone collection of these charges which are uncontested at the level claimed by the Company.

Finally, in GCR No. 5, Trial Staff proposed that the issue of lost and unaccounted for gas be assigned to base rate proceedings. The Commission rejected Trial Staff's proposal, stating (mimeo, p. 10):

> Trial Staff's recommendation that the issue of lost and unaccounted for gas be assigned *solely* to base rate cases would, if adopted, effectively change the GCR formula by causing the cost recovery dollars to be divided by the Mcf *available* for sale. This is an unacceptable result and the ALJ was correct in recommending rejection of the Trial Staff's position. The *recovery* of the cost of lost and unaccounted for gas is a proper function of the GCR formula.

The OCA proposed that Equitable be directed in its Section 1307(f) filings to extend the Section 1307(f) data to a point before the prior calendar year. The OCA also proposed that Equitable be directed to provide its Section 1307(f) data on a jurisdictional basis. Equitable's Section 1307(f) filing was presented in a form fully consistent with the Commission's Regulations. The ALJ concluded that it would be unreasonable to single Equitable out and require it to present data in a manner not required by the Regulations, and that the OCA's proposals are more appropriate for consideration in a generic proceeding.

Although this matter could be the subject of a generic investigation, it does not necessarily have to be considered in such a forum. In its exceptions, the OCA does not indicate that it has attempted to avail itself of discovery procedures. We will not direct the Company to submit data on a jurisdictional basis; however, we anticipate that the OCA will take advantage of the discovery process in Equitable's next 1307(f) proceeding.

In the Conclusion section of the Recommended Decision (pps. 51-52), ALJ Klovekorn recommended that "Equitable should file revised rates designed to reflect the adjustments set forth by Trial Staff in Appendix, p. A-5 of its Main Brief. These adjustments were contained in Appendix A to this recommended decision." In a footnote, the ALJ stated that he adopted the methodology used by Trial Staff but that Trial Staff's arithmetric calculations appear to be incorrect. The ALJ therefore recommended that Trial Staff reexamine the adjustments contained in Appendix A to the Recommended Decision and arithmetically (sic) recalculate the adjustments.

In exceptions, Trial Staff contends that "Trial Staff has rechecked the arithmetic in Appendix A and found that there are no mathmetical errors which affect the proposed gas cost of $3.6084 found on Revised Appendix N of Appendix A."

Equitable's response to the matter of the correctness of Trial Staff's calculations are set forth at pps. 28-30 of its exceptions, to wit:

> A review of the adjustments to Equitable's Section 1307(f) Filing summarized in Appendix A to the Recommended Decision disclosed the following:
>
> 1. Appendix A to the Recommended Decision proposes an increase in purchases from Texas Eastern of 469 MDth to offset a reduction in purchases from Hawks Nest producers for the period September 1, 1985 through August 31, 1986. The reduction in purchases from Hawks Nest had already been reflected in the Update to Reflect Known Changes through April 30, 1985 (Exhibit V-A) and should not be repeated.
>
> 2. The disallowance of purchases from Kentucky West during the period of July 1, 1983 through June 30, 1984, fails to adjust Kentucky West tariff rates for applicable refunds.

3. The adjustments to over/undercollections for the period beginning July 1984 fails to apply Equitable's transition period methodology whereby only one-half of the estimated undercollection for the full eighteen-month period July 1984 through December 1985 is recognized in the adjustment to rates effective September 1, 1985.

With respect to Item 1, above, Equitable has recalculated the "C" factor (Cost of Gas), utilizing Trial Staff adjustments adopted by Judge Klovekorn. The resulting total gas cost allocated to Pennsylvania jurisdictional customers amounts to $218,106,000 versus the $215,919,000 presented in Appendix "A". It appears that the $2,187,000 difference resulted from an erroneous calculation to allocate gas costs to Pennsylvania in addition to the Hawks Nest adjustment (See Attachment I, attached hereto and made a part hereof).

The effect of Item 2 is to reduce the adjustments to Equitable's overcollection by $733,000. This difference was determined by repricing gas purchased from Kentucky West to give effect to refunds applicable to the individual months included in the recommended adjustment.

Finally, Item 3 decreases the overcollection by $1,599,790. This decrease represents recognition of only 50% of the recommended adjustments to over/undercollections pursuant to Equitable's methodology for the transition period. This methodology was not opposed by the Trial Staff.

Applying these corrections to the computations presented in Appendix A to the Recommended Decision would result in a proposed gas cost rate of $3.6886 per MCF versus $3.6084 per MCF.

We have reviewed the calculations and conclude that Equitable's corrections to the Trial Staff's figures in

Appendix A should be made which produces a proposed gas cost rate of $3.6886.

X. CONCLUSION

On the basis of the foregoing, Equitable's proposed rates to recover natural gas costs pursuant to Act 74 of May 31, 1984, as amended, cannot be found to be just and reasonable. Equitable should file revised rates designed to reflect the adjustments set forth by Trial Staff in Appendix, p. A-5 of its Main Brief as further adjusted by Equitable.

As a result of these adjustments, the Company's proposed gas rate should be set at $3.6886 per Mcf instead of the $3.9704 as set forth in Equitable Exhibit V-A.

THEREFORE,

IT IS ORDERED:

1. That Addendum to Tariff Gas-Pa. P.U.C. No. 20 filed by Equitable Gas Company not be placed into effect, the same having been found to be unjust, unreasonable, and, therefore, unlawful.

2. That Equitable Gas Company file tariffs or tariff supplements, upon one day's notice, pursuant to 52 Pa. Code § 3.321(b), effective September 1, 1985, containing rates consistent with the findings herein, which are designed to produce a gas cost rate of $3.6886 per Mcf.

3. That in its next Section 1307(f) filing Equitable Gas Company certify that it has employed separate, independent counsel, with access to a technical staff separate and independent from its affiliated pipeline supplier, Kentucky West Virginia Gas Company, to represent it before the Federal Energy Regulatory Commission.

4. That except as herein modified, the Recommended Decision is adopted as the decision of this Commission.

5. That except as herein granted, specifically or by implication, the Exceptions to the Recommended Decision of the Administrative Law Judge are denied.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: August 28, 1985

ORDER ENTERED: August 29, 1985

APPENDIX H

CONSTITUTIONAL AND STATUTORY PROVISIONS

1. The Supremacy Clause; U.S. CONST. art. VI, cl. 2, provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

2. The Taking Clause; U.S. CONST. amend V, provides:

> [N]or shall private property be taken for public use, without just compensation.

3. The Due Process Clause; U.S. CONST. amend XIV, § 1, provides:

> [N]or shall any State deprive any person of life, liberty, or property, without due proces of law. . . .

4. Excerpts—Natural Gas Act, 15 U.S.C. §§ 717, 717(c), and 717(d) (1982):

15 U.S.C. § 717

NECESSITY FOR REGULATION OF NATURAL GAS COMPANIES

SECTION 1. (a) As disclosed in reports of the Federal Trade Commission made pursuant to Senate Resolution 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling

natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

* * * *

15 U.S.C. § 717(c)

RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to

the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

15 U.S.C. § 717(d)

FIXING RATE AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any

State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

* * * *

5. Excerpts—Pennsylvania Act No. 74, 66 Pa. Cons. Stat. Ann. §§ 1307(a) and (f), 1317, and 1318 (Purdon 1988 Supp.):

§ 1307. Sliding scale of rates; adjustments

(a) General rule.—Any public utility, except common carriers and those natural gas distributors with gross intrastate annual operating revenues in excess of $40,000,000

with respect to the gas costs of such natural gas distributors, may establish a sliding scale of rates or such other method for the automatic adjustment of the rates of the public utility as shall provide a just and reasonable return on the rate base of such public utility, to be determined upon such equitable or reasonable basis as shall provide such fair return. A tariff showing the scale of rates under such arrangement shall first be filed with the commission, and such tariff, and each rate set out therein, approved by it. The commission may revoke its approval at any time and fix other rates for any such public utility if, after notice and hearing, the commission finds the existing rates unjust or unreasonable.

* * * *

(f) Recovery of natural gas costs.—

(1) Natural gas distributors with gross intrastate annual operating revenues in excess of $40,000,000 may file tariffs reflecting increases or decreases in their natural gas costs and the tariffs shall have an effective date six months from the date of filing. The commission shall promulgate regulations establishing the time and manner of such filing, but no such natural gas utility shall voluntarily file more than one such tariff in a 12-month period: Provided, That nothing contained herein shall prohibit any party from advising the commission that there has been or there is anticipated to be a significant difference between the natural gas costs to the utility and the costs reflected in the then effective tariff or the commission from acting upon such advice.

(2) The commission shall hold a hearing or hearings, with notice, to investigate the tariffs. Where there has been an indication of consumer interest, the hearing shall be held in the service territory of the natural gas distributors. Prior to the effective date of the filing, the commission shall issue an or-

der etablishing the rate to be charged to reflect such increases or decreases in natural gas costs. Rates established under this subsection do not contitute either a sliding scale of rates or an automatic adjustment subject to the prohibitions in subsections (a) and (b). Such rates, however, are subject to the same kinds of audits, reports and proceedings required by subsection (d).

(3) Within 60 days following the end of such 12-month period as the commission shall designate, each public utility subject to this subsection shall file with the commission a statement which specifies for such period:

(i) The total revenues received pursuant to this section.

(ii) The total gas expense incurred.

(iii) The difference between the amounts specified by subparagraphs (i) and (ii).

(iv) Evidence explaining how actual costs incurred differ from the costs allowed under paragraph (2) and why such differences occurred.

(v) How these costs are conistent with a least cost procurement policy as required by section 1318 (relating to determination of just and reasonable natural gas rates).

Such report shall be a matter of public record and copies thereof shall be made available by the gas distributor to any person upon request. Copies of the reports shall be filed with the Office of Consumer Advocate at the same time as they are filed with the commission.

(4) The commission shall hold a public hearing on the substance of such statement submitted by a util-

ity as required in paragraph (3) and on any related matters.

(5) The commission, after hearing, shall determine the portion of the companies' actual gas costs in the previous 12-month period which meet the standards set out in section 1318. The commission shall, by order, direct each gas utility subject to this subsection to refund to its patrons any gas revenues collected pursuant to paragraph (2) which exceed the amount of actual gas expenses incurred consistent with the standards in section 1318 and to recover from its patrons any amount by which the actual gas expenses, which have been incurred consistent with the standards in section 1318, exceed the revenues collected pursuant to paragraph (2). Absent good reason to the contrary, the commission shall issue its order within six months following the filing of the statement described in paragraph (3). Refunds to patrons shall be made with interest, which shall be the average rate of interest specified for residential mortgage lending by the Secretary of Banking in accordance with the act of January 30, 1974 (P.L. 13, No. 6), referred to as the Loan Interest and Protection Law, during the period or periods for which the commission orders refunds:

Provided, That nothing contained herein shall limit the applicability of any defenses, principles or doctirnes which would prohibit the commission's inquiry into any matters that were decided finally in the commission's order issued under paragraph (2).

§ 1317. Regulation of natural gas costs

(a) General rule.—In every rate proceeding instituted by a natural gas distribution utility, pursuant to section 1307(f) (relating to sliding scale of rates; adjustments), each such utility shall be required to provide to the commission such information, to be established by com-

mission regulation within 120 days of the passage of this section, that will permit the commission to make specific findings as to whether the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers. Such information shall include, but need not be limited to, information, data and statements regarding:

(1) The utility's participation in rate proceedings before the Federal Energy Regulatory Commission which affect the utility's gas costs.

(2) The utility's efforts to negotiate favorable contracts with gas suppliers and to renegotiate existing contracts with gas suppliers or take legal actions necessary to relieve the utility from existing contract terms which are or may be adverse to the interests of the utility's ratepayers.

(3) The utility's efforts to secure lower cost gas supplies both within and outside of the Commonwealth, including the use of transportation arrangements with pipelines and other gas distribution companies.

(4) The sources and amounts of all gas supplies which have been withheld or have been caused to be withheld from the market by the utility and the reasons why such gas is not to be utilized.

(b) Integrated gas companies.—In the case of a natural gas distribution utility which purchases all or part of its gas supplies from an affiliated interest, as that term is defined in section 2101 (relating to definition of affiliated interest), such utility shall, in addition to the materials required in subsection (a), be required to provide to the commission such information, to be established by commission regulation within 120 days of the passage of this section, that will permit the commission to make specific findings as to whether any purchases of gas from

an affiliated interest are consistent with a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers. Such information shall include, but need not be limited to, statements regarding:

(1) Efforts made by the utility to obtain gas supplies from nonaffiliated interests.

(2) The specific reasons why the utility has purchased gas supplies from an affiliated interest and demonstration that such purchases are consistent with a least cost fuel procurement policy.

(3) The sources and amounts of all gas supplies which have been withheld from the market by the utility or any affiliated interest and the reasons why such gas is not being utilized.

(c) Definition.—As used in this section the term "natural gas," liquified natural gas, synthetic natural gas and any natural gas substitutes.

§ 1318. Determination of just and reasonable natural gas rates

(a) General rule.—In establishing just and reasonable rates for those natural gas distribution utilities with gross intrastate operating revenues in excess of $40,000,000 under section 1307(f) (relating to sliding scale of rates; adjustments) or 1308(d) (relating to voluntary changes in rates) or any other rate proceeding, the commission shall consider the materials provided by the utilities pursuant to section 1317 (relating to regulation of natural gas costs). No rates for a natural gas distribution utility shall be deemed just and reasonable unless the commission finds that the utility is pursuing a least cost fuel procurement policy, consistent with utility's obligation to provide safe, adequate and reliable service to its customers. In making such a determination, the com-

mission shall be required to make specific findings which shall include, but need not be limited to, findings that:

(1) The utility has fully and vigorously represented the interests of its ratepayers in proceedings before the Federal Energy Regulatory Commission.

(2) The utility has taken all prudent steps necessary to negotiate favorable gas supply contracts and to relieve the utility from terms in existing contracts with its gas suppliers which are or may be adverse to the interests of the utility's ratepayers.

(3) The utility has taken all prudent steps necessary to obtain lower cost gas supplies on both short-term and long-term bases both within and outside the Commonwealth, including the use of gas transportation arrangements with pipelines and other distribution companies.

(4) The utility has not withheld from the market or caused to be withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

(b) Limitation on gas purchased from affiliates.—In any instance in which a gas distribution utility purchases all or part of its gas supplies from an affiliated interest, as that term is defined in section 2101 (relating to definition of affiliated interest), the commission, in addition to the determinations and findings set forth in subsection (a), shall be required to make specific findings with regard to the justness and reasonableness of all such purchases. Such findings shall include, but not be limited to findings:

(1) That the utility has fully and vigorously attempted to obtain less costly gas supplies on both short-term and long-term bases from nonaffiliated interests.

(2) That each contract for the purchase of gas from its affiliated interest is consistent with a least cost fuel procurement policy.

(3) That neither the utility nor its affiliated interest has withheld from the market any gas supplies which should have been utilized as part of a least cost fuel procurement policy.

(c) Shut-in gas; special rule.—In determining whether a gas utility has purchased the least costly natural gas available, the commission shall consider as available to the utility any gas supplies that reasonably could have been brought to market during the relevant period but which were voluntarily withheld from the market by the utility or an affiliated interest of the utility.

(d) Other regulatory approvals.—The fact that a contract or rate has been approved by a Federal regulatory agency for interstate ratemaking purposes shall not, in and of itself, be adequate to satisfy the utility's burden of proof that gas prices and volumes associated with such contract or rate are just and reasonable for purposes of this section.

(e) Reports.—Each natural gas distribution utility with gross intrastate annual operating revenues in excess of $40,000,000 shall file with the commission and the Office of Consumer Advocate, in accordance with regulations to be prescribed by the commission, quarterly reports setting forth the actual gas costs incurred by the utility on a monthly basis. Actual gas costs shall be reviewed for their accuracy by the Bureau of Audits at least annually and the results of that review shall be submitted to the commission.

(f) Definition.—As used in this section the term "natural gas" includes natural gas, liquified natural gas, synthetic natural gas and any natural gas substitutes.

Supreme Court, U.S.
FILED
SEP 19 1988
JOSEPH F. SPANIOL, JR.
CLERK

(3)

No. 88-94

In the Supreme Court of the United States

October Term, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY
and
EQUITABLE GAS COMPANY, A DIVISION OF
EQUITABLE RESOURCES, INC.,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION
and
PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE,
et al.,
Respondents

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF RESPONDENT, PENNSYLVANIA PUBLIC UTILITY COMMISSION IN OPPOSITION

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September 19, 1988

**Counsel of Record*

QUESTIONS PRESENTED

1. Whether the United States Court of Appeals for the Third Circuit committed error in upholding a state agency's disallowance of certain wholesale gas costs claimed by a utility when no showing was made before the agency or the District Court that the costs were unavoidable and entitled to recovery under the "filed rate" doctrine?

2. Whether Pennsylvania's least cost fuel procurement policy embodied in Act 74 constitutes a new cost recovery standard that achieved a taking of utility property in violation of the Fifth Amendment and the Due Process Clause of the Fourteenth Amendment?

3. Whether an order of a state agency directing a publicly regulated utility to employ counsel independent of its affiliated supplier violated that utility's right to counsel or its freedom of speech?

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In The Supreme Court Of The United States

October Term, 1988

No. 88-94

KENTUCKY WEST VIRGINIA GAS COMPANY
and
EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC.,

Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION
and
PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE, et al.,

Respondents

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF OF RESPONDENT PENNSYLVANIA PUBLIC UTILITY COMMISSION IN OPPOSITION

Respondent Pennsylvania Public Utility Commission ("PaPUC"), an independent administrative commission authorized to exercise plenary authority over the rates and services of public utilities in the Commonwealth of Pennsylvania pursuant to the provisions of the Public Utility Code, Title 66 Pennsylvania Consolidated Statutes Anno-

tated §§101 *et seq.*, submits this Brief In Opposition To The Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit at No. 87-5052.

COUNTER-STATEMENT OF THE CASE

The PaPUC concurs in the majority of factual assertions made by Petitioners Kentucky West Virginia Gas Company and Equitable Gas Company, a division of Equitable Resources, Inc. ("Petitioners" or "Kentucky West").[1] Petitioners are incorrect, however, when they argue in their Statement that the PaPUC took action against Equitable that was similar to state action barred by this Court's recent decision in *Mississippi Power & Light Co. v. Mississippi*, U.S. , 108 S.Ct. 2428 (1988). Equitable suggests that while before the PaPUC it defended its gas purchases from its affiliated supplier, Kentucky West Virginia Gas Company, as being consistent with Act 74's requirements due to the existence of a minimum bill obligation with that pipeline supplier. Petition at 6-7. In fact, Equitable's primary defense of Kentucky West purchases was based on its belief that a pro rata purchasing strategy dictated a certain level of purchases from Kentucky West so that a reliable supply of gas would be available from that Company in the future. App., *infra*, 116a, 124a.

Equitable's Statement also makes other important omissions that bear on the issue of whether the PaPUC ignored minimum bill costs. Due to demand constraints in 1983 and 1984 Equitable invoked the *force majeure* clauses in its gas contracts with Tennessee Gas Pipeline

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[1] Occasional references will be made to "Equitable" to distinguish Equitable Gas Company, a distributor of gas, from its pipeline supplier, Kentucky West.

Company, Texas Eastern Transmission Corporation and Kentucky West Virginia Gas Company and declined to pay any minimum bill charges. It "informed its suppliers that Equitable would pay only for gas taken." App., *infra*, 128a. At the time the PaPUC decided Equitable's 1985 gas cost proceeding, the Company had not made any minimum bill payments to Kentucky West. App., *infra*, 128a, 132a. Equitable argued before the PaPUC that its costs incurred from Kentucky West should be granted a pass-through because this supply was more reliable than gas from Tennessee or Texas Eastern and that denial of any costs actually paid Kentucky West would constitute an attempt by the agency to redetermine FERC approved pipeline rates. App., *infra*, 117a, 124a.

Equitable's complaint filed with the District Court for the Middle District of Pennsylvania alleged that certain sections of Act 74 and the PaPUC order violated the Supremacy Clause of the U.S. Constitution. The complaint mentions the need to purchase gas below minimum bill levels but it did not allege that the PaPUC improperly refused to allow Equitable to collect unavoidable minimum bill costs from ratepayers. C.A. App. 9-25.[2] Rather, the complaint contended that the Natural Gas Act and the Natural Gas Policy Act guaranteed Equitable the right to pass-through to its customers any cost incurred pursuant to any FERC approved rate regardless of the availability of lower cost alternative supplies. C.A. App. 22. Specifically, Equitable asked the District Court to "declare costs in-

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[2] Equitable's complaint refers to a $713,000 disallowance of minimum bill costs by the PaPUC. C.A. App. 19. However, this statement refers to a disallowance relating to a prospective twelve month period ending July 31, 1986 that the PaPUC adopted due to Equitable's historic failure to pay minimum bill charges. This adjustment has not been challenged by Kentucky West.

curred or to be incurred by Equitable pursuant to any FERC approved tariff rate schedule to be just and reasonable as a matter of law for purposes of the Pennsylvania Public Utility Code". C.A. App. 24. Equitable's complaint was factually incorrect when it alleged that minimum bill contract provisions required it to "purchase" a minimum amount of gas. C.A. App. 16. The District Court found that a minimum bill, while typically requiring a payment, does not require the "purchase" of gas. App., *infra*, 45a.

Kentucky West's first attempt to show that the PaPUC had ignored unavoidable minimum bill charges materialized in its brief to the Court of Appeals through a calculation found in a footnote that was the subject of a Motion To Strike by the PaPUC. The Court of Appeals specifically found that the record did not support the inference that minimum bill costs had been blocked since Equitable never challenged before the District Court the PaPUC's findings that minimum bill payments had not been made to Kentucky West and that the prospect of future minimum bill payments was too speculative to justify their inclusion in rates. App., *infra*, 21a, 35a-36a.

Equitable fails to mention that its refusal to pay Kentucky West any minimum bill charges was resolved by a Federal Energy Regulatory Commission ("FERC") order issued after the PaPUC concluded its 1985 Act 74 investigation. *Kentucky West Virginia Gas Co.*, 33 FERC ¶ 61,240 (1985). Following this settlement with Kentucky West, Equitable requested recovery of $2.5 million in minimum bill costs paid to Kentucky West that related to the $14.3 million disallowed in the 1985 proceeding. The PaPUC allowed recovery of this claim in 1987 in consideration of the fact that it constituted minimum bill costs owed to Kentucky West and the payment of this minimum bill

was unascertainable in the 1985 proceeding. *PaPUC v. Equitable Gas Co.*, 87 PUR 4th 131, 138 (1987); C.A. App. 762-770.[3]

REASONS FOR DENYING THE PETITION

A. This Court Should Not Exercise Its Discretion To Review Whether the "Filed Rate" Doctrine Was Violated When There Was no Showing at Trial That Unavoidable Wholesale Costs Were Denied Recovery in Retail Rates

1. Kentucky West has not demonstrated that the PaPUC disallowed unavoidable minimum bill costs.

It is clear from Kentucky West's Petition for the Grant of Certiorari that it has discarded its attack on the facial constitutionality of Act 74 and its theory that a state agency must allow the pass-through of all costs incurred pursuant to any FERC approved rate. These claims were the heart of Kentucky West's complaint before the District Court. Kentucky West has now moved to center stage an argument not raised before the District Court to the effect that the PaPUC ignored minimum bill costs imposed on Equitable by Kentucky West and thus violated the "filed rate" doctrine. *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951); *Arkansas-Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981).

The Court of Appeals did not commit error when it declined to agree with Kentucky West regarding this mini-

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[3] Equitable Gas Company made an additional claim for $10.2 million in Kentucky West minimum bill costs relating to the 1983-1984 period in its recently concluded 1988 gas cost recovery proceeding before PaPUC. This claim was rejected because Equitable did not satisfy its burden of proof to demonstrate that these costs had actually been paid to Kentucky West. In addition, payment of such amounts conflicted with the settlement of minimum bill liability previously reached with Kentucky West. *PaPUC v. Equitable Gas Co.*, No. R-880932, Slip Op. at 5-13 (September 1, 1988).

mum bill argument. Kentucky West's failure to adequately raise and substantiate this issue below is well documented by the record. It is clear that at the time the PaPUC decided the 1985 gas cost recovery proceeding, Equitable had taken the position that it was legally excused from paying its pipeline supplier's minimum bills due to a declaration of *force majeure*. App., *infra*, 128a. Equitable's policy was to pay only for gas actually taken. *Id*. The basis of the PaPUC adjustment was that given this policy, Equitable did not purchase or take gas in a manner that would produce the lowest cost result for its retail customers. Kentucky West contends that the PaPUC ignored minimum bill liability since it failed to recognize "an FERC-imposed duty to purchase gas from Kentucky West and pay the tariff rate for that gas." Petition at 17. This statement is misleading since Equitable was never under any obligation to physically take gas from Kentucky West. The District Court recognized that a minimum commodity bill, while ordinarily requiring a payment, does not require the purchase of gas. App., *infra*, 45a.[4]

The District Court found that the PaPUC had not improperly disallowed any FERC approved rate. App., *infra*, 59a-60a. When Kentucky West presented the argument that the PaPUC had ignored unavoidable minimum bill

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[4] In footnotes 12 and 16 Petitioners attempt to designate the amounts paid to Kentucky West for gas actually taken in 1983 and 1984 as minimum bill costs. This characterization is apparently adopted to rationalize Equitable's failure to claim the entire, supposedly unavoidable, Kentucky West minimum bill before the PaPUC and to make the claim before the District Court for recovery of amounts paid to Kentucky West synonymous with a claim for "minimum bill" costs. Kentucky West, in footnote 16, erroneously refers to "federally required purchases" being at issue in this case. The Kentucky West tariff did not *require* any purchases. Moreover, minimum bill obligation does not attach to gas taken. When applied, it increases a buyer's costs for quantities of gas *not taken*.

costs before the Court of Appeals, the Court noted Kentucky West's failure to raise and substantiate this claim below:

> In conformity with our power of plenary review, we undertook a time-consuming analysis of the proceedings below to ascertain whether Equitable had raised the question of its minimum bill obligation in the context now developed on appeal. We conclude that Equitable failed to provide an analytic framework supporting an argument that the $14.3 million disallowance represented an unavoidable FERC-approved contractual obligation. *The record simply does not demonstrate that any portion of the disallowed costs represented Equitable's minimum bill obligation.*
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> * * *
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> The PUC found that no minimum bill costs had ever actually been incurred, and therefore declined to take them into consideration in setting the retail rate for the period in question. This uncertainty as to what minimum bill costs, if any, would *ever* be incurred by Equitable also justified the PUC's refusal to consider minimum bill liability in evaluating whether Equitable has pursued a least cost fuel procurement policy for the twelve month period under examination.
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> * * *
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> Finally, with respect to the challenge to the disallowance of allegedly unavoidable costs, *the only portion of the $14.3 million which could be characterized as unavoidable costs would be minimum bill charges actually incurred*. As we noted previously, the PUC disallowed the pass-through based on its findings that the purchases from Kentucky West were imprudent, even

> though already below minimum bill levels, because cheaper gas was available from alternate suppliers, *no minimum bill payments had ever been made to Kentucky West by Equitable*, and the likelihood that such payments would ever be made was too speculative and uncertain to justify inclusion of them in Equitable's estimated cost of service. Those findings were unchallenged before the district court, and the first finding above was affirmed by the Pennsylvania Commonwealth Court. Therefore, *this record cannot support an inference that the costs were unavoidable*.

App., *infra*, 21a, 35a-36a. (Emphasis added.) The appropriateness of the finding below regarding minimum bill is further bolstered by the fact that in 1987, the PaPUC allowed Equitable to collect the minimum bill expense that related to the $14.3 million adjustment after FERC approved a Kentucky West/Equitable settlement of the minimum bill controversy. FERC modified Kentucky West's minimum bill by approving a settlement agreement. *Kentucky West Virginia Gas Co.*, 33 FERC ¶ 61,240 (1985). Equitable was granted recovery of $2.5 million in Kentucky West minimum bill charges by the PaPUC in *PaPUC v. Equitable Gas Co.*, 87 PUR 4th 131 (1987):

> Equitable now contends that the adjustment approved at Docket No. R-850038 is incomplete in that it failed to reflect the minimum bill effect of disallowed Kentucky West purchases.
>
> * * *
>
> In this proceeding the Company has adjusted its purchased gas costs by $2,552,833 which represents only the fixed cost portion of its alleged $15,000,000 minimum bill deficiency to Kentucky West under the Commission's previously approved gas supply mix.
>
> * * *

> Therefore we will permit Equitable to include in rates that fixed cost portion of those gas volumes below minimum bill. This is consistent with our understanding of the operation of FERC approved minimum bills.

C. A. App. 766, 772.

Before this Court can reach the issue of whether a denial of a utility's minimum bill liability by a state agency conflicts with the "filed rate" doctrine it must overturn the fact finding performed by the PaPUC and District Court and find that the Court of Appeals erred in ruling on whether the minimum bill issue had been properly raised. This is a prerequisite because the underlying assumption of Kentucky West that an unavoidable FERC approved cost was ignored has not been established below or even properly raised in the view of the Court of Appeals. A grant of certiorari would place this Court in the position of addressing an issue of alleged conflict with the "filed rate" doctrine that was not dealt with, for good reason, by the Court of Appeals. This Court has observed that certiorari is not granted to review evidence and discuss specific facts. *United States v. Johnston*, 268 U.S. 220, 227 (1985). A fact crucial to Kentucky West's argument—that the PaPUC refused to pass-through in retail rates an unavoidable FERC approved cost incurred by Equitable—has not been established below.

Neither the District Court nor the Court of Appeals found facts that support Kentucky West's theory that the PaPUC "trapped" FERC approved costs by refusing to pass-through unavoidable minimum bill costs. To the contrary, the Court of Appeals found that no factual support existed for Kentucky West's allegation that the PaPUC set rates that "trapped" FERC approved costs. The fact finding

of the PaPUC that established the failure of Equitable to incur and pay minimum bill expenses should be given the same preclusive effect as the fact finding of state courts. *University of Tennessee v. Elliot*, 478 U.S. 788 (1986).

The Courts below have determined that the record does not support a finding that the PaPUC denied recovery of an unavoidable FERC approved expense. Kentucky West has simply not provided this Court with a factual foundation that allows the Court to explore the legal issue it raises of conflict between state ratemaking authority and the "filed rate" doctrine. Moreover, Kentucky West has not explained why a grant of certiorari is appropriate given Equitable's request and receipt of minimum bill costs relating to the $14.3 million adjustment in its 1987 rate proceeding. This Court should leave the findings of the Courts below undisturbed and decline to grant review.

2. Current FERC policy renders the issue of conflict between state ratemaking treatment of pipeline minimum bills and the "filed rate" doctrine unimportant and not worthy of review.

Kentucky West has not established that the PaPUC ignored unavoidable minimum bill expenses in setting intrastate retail rates for Equitable.[5] Even if the facts were as Kentucky West alleges, the need for the Court to reach this issue is diminished by the fact that FERC has moved to eliminate this type of tariff provision from the tariffs of interstate pipelines. Guidance from the Court on this issue is simply not warranted given the passing of minimum bills from the scene of interstate pipeline tariffs.

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[5] Kentucky West suggests that FERC agrees with its analysis that the PaPUC was "obligated to take account" of FERC-approved tariffs. FERC however, has never joined Kentucky West in its argument that the PaPUC ignored unavoidable FERC approved charges in its rate order and has not taken a position on the factual basis for Equitable's claim.

Pipeline minimum commodity bills were generically attacked by FERC in 1984 when it directed the removal of variable costs from pipeline minimum commodity bills. *Elimination of Variable Costs From Certain Pipeline Minimum Commodity Bill Provisions*, 27 FERC ¶ 61,318 (1984). At that time FERC allowed fixed-costs to remain in pipeline minimum bill tariff provisions. However, in subsequent proceedings involving individual pipelines, FERC has resolutely moved to eliminate the minimum bills altogether.

At the time of the PaPUC order at issue in this case, Equitable was served by three interstate natural gas pipelines-Kentucky West Virginia Gas Company, Tennessee Gas Pipeline Company and Texas Eastern Transmission Company. In an order issued on June 22, 1988, the FERC eliminated Kentucky West's minimum commodity bill retroactive to March 2, 1986 having found the bill to be "anticompetitive". *Kentucky West Virginia Gas Company*, 43 FERC ¶ 61,496 (1988).[6] FERC has also struck down the minimum bills of Equitable's two other pipeline suppliers. *Tennessee Gas Pipeline Company*, 36 FERC ¶ 61,071 (1986): (The minimum bill is anticompetitive and produces an inequitable result); *Texas Eastern Transmission Corporation*, 43 FERC ¶ 61,076 (1988): ("Texas Eastern does not need minimum bills to compete . . . .").

The elimination of minimum bills by FERC is not a phenomenon that has only involved Equitable's pipeline suppliers. It has affected the natural gas industry nationwide. *ANR Pipeline Co.*, 37 FERC ¶ 61,263 (1986): ("[O]ur review of the initial decision and the record demonstrates that ANR's minimum bills are unlawful and should be

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[6] This order is currently the subject of a Request for Rehearing at FERC.

eliminated."); *Panhandle Eastern Pipe Line Co.*, 38 FERC ¶ 61,164 (1987): (FERC affirms ALJ finding that the minimum bill is anticompetitive and should be eliminated from the LS and SS schedules); *Transcontinental Gas Pipe Line Corporation*, 44 FERC ¶ 61,216 (1988): ("Transco must eliminate its minimum bill effective April 1, 1987."); *Transwestern Pipeline Co.*, 32 FERC ¶ 61,009 (1985) *affirmed Transwestern Pipeline Co. v. FERC*, 820 F.2d 733 (5th Cir. 1987): ("[W]e affirm the judge and hold that Transwestern's minimum bills are unduly discriminatory and therefore unlawful . . . .").

Kentucky West has argued to this Court that it should grant certiorari so that "confusion" will not be created in the future by the Court of Appeals decision. However, FERC's steady elimination of pipeline minimum bills makes it unlikely that future litigation will arise on the issue of conflicts between state agency treatment of minimum bills and the "filed rate" doctrine. Obviously, the issue will not be of continuing importance to Equitable as all three of its pipeline suppliers have lost their minimum bills. The question raised by Kentucky West of whether the Court of Appeals failed to recognize a conflict between state ratemaking involving minimum bills and the "filed rate" doctrine is not relevant to potential future controversies. No useful guidance to future parties and the Courts would be gained by granting review of this issue.

B. The Decision of the Court of Appeals Fully Comports With *Nantahala* and *Mississippi Power*

Kentucky West attempts to show that conflict exists between the decision of the Court of Appeals and this Court's recent decisions involving the "filed rate" doctrine in *Nantahala Power & Light Co. v. Thornburgh*, 476 U.S.

953 (1986), and *Mississippi Power & Light Co. v. Mississippi*, U.S. , 108 S.Ct. 2428 (1988). Neither of these cases bars the action of the PaPUC taken with respect to Equitable's retail rates. Together, *Nantahala* and *Mississippi Power* provide a recent, clear explanation of the limits of state ratemaking vis-a-vis the "filed rate" doctrine by this Court such that no further elaboration of the boundaries of state and federal ratemaking authority is necessary.

Nantahala clearly set forth the proposition that state agencies may not alter FERC approved rates for retail rate purposes such that costs are "trapped" between the actual wholesale FERC rate paid and the retail rate permitted. This Court, however, specifically separated from its holding in *Nantahala* the situation where a utility has an array of wholesale energy rates available to it, including FERC approved rates, and does not select the supplier that will produce the lowest retail rate:

> Without deciding this issue, we may assume that a particular quantity of power procured by a utility from a particular source could be deemed unreasonably excessive if lower cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable price.

476 U.S. at . This qualification to *Nantahala* was fully understood by the Court of Appeals which found it applicable to the present case:

> Although *Nantahala* underscores that a state cannot independently pass upon the reasonableness of a wholesale rate on file with FERC, it in no way undermines the long-standing notion that a state commission may legitimately inquire into whether the retailer prudently chose to pay the FERC-approved wholesale

> rate of one source, as opposed to the lower rate of another source.
>
> We interpret *Nantahala* as preempting state commissions from questioning or altering the wholesale rate and compelling them to accept it when determining pass-through in their retail rate-setting procedures.

App., *infra*, 17a. The Court of Appeals thus upheld the District Court's finding below that no conflict existed between the "filed rate" doctrine and the PaPUC order:

> The PUC did not disallow any FERC approved rate or any rate FERC must accept as a consequence of the NGPA. It accepted all of those rates as they appeared in Equitable's suppliers' cost structures. It simply chose from among all of those competitors, the gas supply that, in its view, would have resulted in the lowest cost to Equitable.

App., *infra*, 59a. The District Court had recognized the distinction previously made by the Pennsylvania Commonwealth Court in *Pike County Light and Power Co. v. PaPUC*, 77 Pa. Commonwealth Ct. 268, 465 A.2d 735 (1983) between a state agency's illegal review of the reasonableness of a FERC approved rate and an inquiry into the prudence of a utility's purchase decision given alternative supply sources. *Pike* at 274-5, 738. In 1985, the PaPUC engaged in a permissible review of Equitable's purchasing decision.

Although *Mississippi Power* was not available at the time the Court of Appeals rendered its decision, it requires no modification of the Court's result. This Court held in *Mississippi Power* that a state investigation of utility prudence was barred when FERC created an unavoidable obligation on the part of a utility customer to pay its

share of plant costs. *Mississippi Power* involved FERC's allocation of costs on a highly integrated affiliated utility system. FERC has not only set a wholesale rate, but it ordered the retail utility, Mississippi Power & Light, to pay for high-price Grand Gulf power. *Id.* at 2440. Again, as in *Nantahala* this Court noted, however, that:

> it might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power.

Mississippi Power at 2440.

Kentucky West failed to convince the District Court or the Court of Appeals that it was faced with an FERC-approved legal obligation to incur costs that implicated the "trapping" of costs prohibited by *Nantahala* and *Mississippi Power*. This failure on the part of Kentucky West to establish facts that bring its case within the bounds of *Nantahala* and *Mississippi Power* demonstrates that there is no conflict between the Court of Appeals' decision and the recent decisions of this Court involving the "filed rate" doctrine. The parameters of this doctrine are clear and require no further elaboration. No ambiguity remains after *Nantahala* and *Mississippi Power* that merits the grant of certiorari. *McDaniel v. Sanchez*, 452 U.S. 130, 136 (1981). The absence of conflict between the Court of Appeals and the recent decisions of this Court argues in favor of denying review.

C. Act 74 Did Not Create a New Ratemaking Standard That Effected a Confiscation of Equitable's Property

Kentucky West argues that Act 74 imposed a new ratemaking standard on utilities that could not have been anticipated by investors. Thus, according to Petitioners,

the PaPUC's rate disallowance effected a "taking" of property without due process in violation of the Fifth and Fourteenth Amendments. In response, PaPUC submits that Act 74 did not impose a new rate "standard" and that Kentucky West has failed to establish that any confiscation of property has occurred.

It is contended by Kentucky West that the PaPUC applied new and different standards to gas cost recovery claims when it commenced administering Act 74 after its effective date on July 30, 1984. Kentucky West alleges that the PaPUC moved from a standard of "just and reasonable" to the standard of least cost procurement. Act 74 did not repeal the basic mandate in Section 1301 of the Public Utility Code that "*[e]very* rate made, demanded, or received by any public utility, . . . shall be just and reasonable. . . ." (Emphasis added.) 66 Pa. C. S. 1301. Moreover, Act 74, did not modify the PaPUC's ongoing duty to only set rates that are "just and reasonable". The Act itself references the "[d]etermination of just and reasonable natural gas rates" and informs us that "[n]o rates for a natural gas distribution utility shall be deemed *just and reasonable* unless the commission finds that the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers". (Emphasis added.) App., *infra*, 173a.

Kentucky West has failed to show that the era of the PaPUC's "just and reasonable" standard that supposedly expired when Act 74 became effective, in any way conflicted with Act 74's requirement that utilities follow a least cost fuel procurement policy. Although the Act requires the PaPUC to make a variety of specific fact findings regarding procurement activity of utilities that previously were discretionary, the basic mandate that utilities obtain

the lowest cost gas available was in effect before Act 74 became effective.

Prior to the passage of Act 74, the PaPUC set gas cost recovery rates according to the GCR (Gas Cost Recovery) procedure. This mechanism was first employed in 1978 and continued in effect until Act 74 was implemented. *Re Gas Cost Rates*, 52 PaPUC 217, 220 (1978): ("The Commission shall continuously review the reasonableness and lawfulness of the amounts of the charges produced by the gas cost rate and the charges included therein.") As with any fuel adjustment clause procedure, recovery of costs was dependent upon the utility making prudent, reasonable, low cost purchases of fuel. *Metropolitan Edison v. PaPUC*, 62 Pa. Commonwealth Ct. 460, 466-67, 437 A.2d 76, 80-81 (1981): (Metropolitan Edison failed to exercise proper managerial prudence in administering its coal contracts and as a result of imprudence, ratepayers were forced to pay unjust and unreasonable rates under the utility's fuel adjustment clause.)

The "least cost" procurement standard of Act 74 was essentially in effect as a ratemaking standard when utilities, including Equitable, were governed by the GCR process. The PaPUC stated in *Re Gas Cost Rate No. 5*, 58 PUR 4th 369 (1984):

> We will not hesitate to exercise our full authority to withdraw the authorization to utilize the *GCR* of any utility that continually ignores its obligations *to aggressively seek the lowest cost gas for its customers.*

58 PUR 4th at 374 (Emphasis added.) It is clear that the "least cost" objective was applied to Equitable and other gas utilities prior to the application of Act 74. Indeed it has always been a basic tenet of ratemaking jurisprudence that a utility is obligated to avoid excessive and unnecessary ex-

penditures. *Chicago & Grand Trunk Ry. Co. v. Wellman*, 143 U.S. 339, 345-46 (1892).

Equitable cites the PaPUC's approval of its gas cost claim in *Re Gas Cost Rate No. 5* to suggest that its conduct was prudent, in the PaPUC's view, before Act 74 but that it was deemed not prudent on identical facts in the case that resulted in a $14.3 million disallowance under Act 74. However, the facts presented to the PaPUC in these two cases were different and justified different results. During the period under review in *Re Gas Cost Rate No. 5* Equitable had not declared *force majeure* and adopted a policy of paying only for gas actually taken. These new facts justifiably produced a different assessment by the PaPUC of whether Equitable had obtained the lowest cost gas available.

Equitable's investors faced no greater or different regulatory risk after the passage of Act 74. A utility's ability to recover out-of-pocket gas cost expenses prior to Act 74 was dependent upon management making reasonable, prudent, low cost choices when it purchased gas. Act 74 introduced no new or novel requirement that investors could not have anticipated.[7]

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[7] The PaPUC observes that the Court of Appeals never addressed the issue of whether Act 74 introduced a new legal standard to Pennsylvania gas cost recovery proceedings that changed investors' expectations. The Court of Appeals did not have the opportunity to consider this argument because Kentucky West raises it for the first time in its Petition to this Court. The argument raised by Kentucky West before the Court of Appeals regarding retroactivity went to the issue of whether the PaPUC could make *any* disallowance with respect to a prior historic period. Kentucky West never contended before the Court of Appeals that Act 74 introduced new or different legal standards. C.A. App. 827-829. Certiorari should not be granted to address issues not previously raised in the Court of Appeals.

Kentucky West criticizes the Court of Appeals for concluding that Equitable voluntarily accepted the standards of Act 74 for the period July 1983 to July 1984 when it made a filing under the Act rather than pursue its costs under Section 1308 of the Public Utility Code, 66 Pa. C. S. §1308, which governs general rate cases. Petitioners assert that the Court was in error since the "least cost fuel procurement" standard is mandated in Section 1308 cases as well. The PaPUC, however, disputes Petitioner's new contention that it faced a new regulatory standard in claiming gas cost expenses after Act 74 became effective. Therefore the issue of whether a particular type of rate proceeding granted more or less protection from regulatory scrutiny is irrelevant.

In addition to not having established that the PaPUC retroactively applied a new legal standard regarding gas cost recovery, Kentucky West has failed to demonstrate that any "taking" of its property has occurred. Factors relevant to a litigant's substantiation of a public taking include the ecomonic impact of the regulation, the degree to which the action interferes with investment-backed expectations and the character of the governmental action. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 432 (1982), *citing Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124 (1978). In this case Kentucky West has not proven that the PaPUC's action has prevented Equitable from meeting its operating expenses and moving forward as a business entity. The economic impact of the governmental action does not establish that a taking has occurred. Moreover, the rate adjustment reflected application of long-standing notions of what constitutes a reasonable expense that should be permitted in rates. Investment-backed expectations have therefore not been disrupted by the PaPUC order. Finally, the character of the gov-

ernmental action, disallowance of an unreasonable expense by a state utility commission, weighs heavily in favor of a rejection of the takings argument. Protection of the public from unreasonable rates is part of the long recognized police power of the states. *Arkansas Electric Cooperative Corp. v. Arkansas Public Utility Commission*, 461 U.S. 375 (1983).

Allegations of unconstitutional takings in a ratesetting context have been governed for the past forty years by this Court's holding in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). *Hope* has effectively taught for these intervening decades that investor property interests are implicated only if the end result of a rate order causes significant harm to investors. Indicia of significant harm could include insufficient revenue for operating expenses and capital costs such as service on debt and dividends. *Hope* at 603. Even if evidence of such harm is presented, an unconstitutional "taking" has not been established if consideration of consumer interests justifies the rate disallowance. *Id.* In *Hope*, the Court found confiscation nowhere in sight even though the return allowed, under the utility's rate base assumptions, was "meager". *Hope* at 605. Similarly, Equitable's calculation of a "meager" return on equity does not establish that confiscation has occurred. Petitioners have not produced threshold evidence of financial harm of the type that justifies a further judicial inquiry into the issue of whether consumer and investor interests were properly balanced.[8] Kentucky West has made no showing that it is

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[8] Kentucky West's reference to an absence of return on equity does not necessarily constitute a showing of significant harm to investors such that a court must engage in an evaluation of whether ratepayer and shareholder interests have been properly balanced. It is significant that Kentucky West has not substantiated a diminished capacity or an inability to raise capital or meet operating expenses.

the victim of a confiscatory rate order through the retroactive imposition of a new legal standard for ratemaking. The PaPUC's application of Act 74 to Equitable does not present an important issue that requires review by this Court.

This Court's notation of probable jurisdiction in *Duquesne Light Co. v. Barasch, prob. juris noted*, U.S. , 108 S.Ct. 1105 (1988) does not provide grounds for granting review of this case. *Duquesne Light* concerns a utility's effort to recover its investment in cancelled nuclear projects on the grounds that all prudent investment should be recognized in retail rates. The Pennsylvania Supreme Court interpreted Section 1315 of the Public Utility Code, 66 Pa. C. S. §1315, to prohibit the recovery of any costs incurred in the construction of electric utility plants until such property is "used and useful" regardless of the prudence of the investment. The issue of whether prudent investment must be allowed in rates does not arise in the present case because Equitable's expenses have been deemed to fail the test of prudence. Furthermore, there is no evidence that the statutes involved in the present case, Act 74, involve a new legal standard that was given retroactive effect as has been alleged in *Duquesne Light*. Consolidation of this case with *Duquesne Light* is inappropriate given the significant differences of fact and law that exist between these proceedings.

D. The Decision of the Court of Appeals in no Way Conflicts With This Court's Prior Rulings on a Person's Right to Counsel, or Free Speech

Supreme Court Rule 17.1(c) provides that when determining grants of certiorari the Court will consider whether the decision below is in conflict with "applicable decisions of this Court" on federal questions. Kentucky

West has alleged that the decisions below, beginning with that of the PaPUC, have deprived it of its right to counsel and infringed upon its freedom of speech. Petition at 24-28. Although Kentucky West appears to be abandoning its right to counsel arguments in favor of the free speech claim, both positions are nonetheless groundless.

As part of its annual investigation under Act 74, the PaPUC examined whether Equitable had fully and vigorously "represented the interests of its ratepayers before the FERC". App., *infra,* 145a-148a. This is an inquiry mandated by Sections 1317 and 1318 of Act 74. 66 Pa. C. S. §§1317, 1318. App., *infra,* 172a, 174a. The propriety of the PaPUC's directive that Equitable obtain its own counsel in Kentucky West cases is clear if one examines the relationship of these two companies.

Equitable sells gas at the retail level in the Pittsburgh area. It is owned by Equitable Resources, Inc. ("Equitable Resources") which also owns Kentucky West Virginia Gas Company, an interstate gas pipeline. Only Equitable is subject to the jurisdiction of the PaPUC and it alone is subject to the PaPUC's order below. Equitable is a major purchaser of natural gas from its sister company, Kentucky West. These transactions are regulated by the FERC.

The PaPUC found that although Equitable vigorously participated in FERC rate actions involving its other gas pipeline suppliers, it, by its own admission, "does not participate as actively in Kentucky West FERC proceedings as it does in those involving Texas Eastern and Tennessee [its other suppliers]". App., *infra,* 146a. It was Equitable's position before the PaPUC that the participation of other intervenors at FERC justified its failure to participate in the rate cases of its affiliated supplier, Kentucky West. The PaPUC noted that interlocking relationships exist among

Equitable, Equitable Resources and Kentucky West. App., *infra*, 147a.

> Equitable's ratepayers have the right to expect the utility to represent in an effective manner their interests before the FERC in proceedings involving all of Equitable's pipeline suppliers. A serious question arises as to whether such representation can take place in view of Equitable's present corporate structure.

App., *infra*, 148a.

In an attempt to remedy this potential conflict of interests, the PaPUC adopted the recommendation of its Trial Staff that Equitable be directed to obtain counsel and technical support staff "wholly separate from Kentucky West". App., *infra*, 148a. It is in this context that the Equitable Companies complain they have been deprived of the choice of counsel.

The District Court declined to rule on this issue, stating that the PaPUC could bring this matter to the FERC. App., *infra*, 43a. However, the Court of Appeals examined the question and sustained the PaPUC's decision. The Court noted that the right to counsel does not necessarily guarantee the right to choose a particular attorney. App., *infra*, 38a.

> Inherent in the right to counsel is the right to the assistance of counsel unimpaired by the conflict arising from joint representation.
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> * * *
>
> [W]here there exists a potential for conflict, ordering parties to retain separate counsel violates neither due process nor the APA [Administrative Procedure Act].

App., *infra*, 38a; citations omitted. This is the full extent of the PaPUC's order. It has done nothing more than direct Equitable Gas to retain *independent* counsel.

The Equitable Companies posit that "the order requires Equitable to hire counsel to make arguments contrary to the interests of its sister company, Kentucky West." Petition at 27. It states that it is being forced to appear at an administrative proceeding and to hire counsel to advocate positions with which it disagrees. Petition at 25.

With respect to the former statement, the PaPUC has never ordered Equitable to take positions *contrary* to that of Kentucky West. Equitable was directed to defend the interests of its own customers which, at the FERC, coincide with those of Equitable itself. For example, by striving to keep the prices of its pipeline suppliers low, Equitable can keep its supply expenses to a minimum and minimize the gas bills of its customers.

As this Court has noted, the primary purpose of Pennsylvania public utility law is to "serve the interests of the public". *Jackson v. Metropolitan Edison*, 419 U.S. 345, 352 n. 8 (1974). Regulation to such ends is permissible when it comports with due process of law.

> The Fifth Amendment, in the field of Federal activity, and the Fourteenth, as respects state action, do not prohibit governmental regulation for the public welfare. They merely condition the exertion of the admitted power, by securing that the end shall be accomplished by methods consistent with due process. And the guaranty of due process . . . demands only that the law shall not be unreasonable, arbitrary, or capricious, and that the means selected shall have a real and substantial relations to the object sought to be attained.

Nebbia v. New York, 291 U.S. 502, 525 (1934).

The PaPUC's goal, of insuring that Equitable's customers are able to purchase natural gas service at the lowest reasonable cost, is no different than that of virtually every other state public utility commission as well as the FERC.

In order to accomplish that goal the PaPUC has merely directed that Equitable, as a buyer of gas, should retain counsel independent of Kentucky West, the seller of the gas. The Court of Appeals correctly found this remedy to be in conformity with federal law. As such, there is no controversy for this Court to decide.

The reliance by the Petitioners upon *Walters v. National Assn. of Radiation Survivors*, 473 U.S. 305 (1985) is misplaced. The Court, in *Walters*, sustained a federal statute which limited attorneys' fees to $10 for veterans seeking benefits for service-connected death or disability. *Walters, supra*, at 307. Two veterans' organizations and a number of veterans had maintained that the limit on attorney awards effectively prevented veterans from obtaining counsel when appearing before the Veterans Administration's Board of Veterans' Appeals ("BVA"). The government argued that the system was set up to be informal so that veterans could represent themselves alone or with the assistance of veteran groups. The administrative system was non-adversarial in nature with ambiguities always being resolved in favor of the veteran. *Id*. at 310-312. This Court reversed a District Court order which had struck down the $10 limit. The Court held that where there was no adversarial trial-type proceeding, the "need for counsel is considerably diminished". *Id*. at 333-334.

The *Walters* decision is inimical to the First Amendment argument set forth by the Petitioners that Equitable Gas must argue against Kentucky West's interests. In dis-

missing the veterans' claim that a lack of an attorney did violence to a veteran's right to free speech before the BVA, the Court held that so long as the veteran could effectively present his or her case without an attorney there was no bar to free speech. *Id.* at 334-335. In short, an attorney was not necessary to ensure that a veteran's position would be fully presented in the BVA proceedings.

The situation *sub judice* is clearly distinguishable from *Walters*. Equitable has been directed to obtain independent counsel. It is in no way being deprived of counsel.

The Equitable companies will find no solace in their reliance upon *Pacific Gas and Electric Co. v. Public Utilities Comm. of California*, 475 U.S. 1 (1986). As the Court is aware, in *Pacific Gas* it struck down an order of the California PUC which gave a consumer group access to the unused portion of Pacific Gas and Electric Company's (PG&E) monthly customer billing envelopes four times a year. The Court held that this order forced PG&E to use its property, the unused portion of the envelope, to facilitate the expression of views with which it did not agree. *Pacific Gas, supra*, at 12. The Court also found that this forced PG&E to respond to the speech with which it disagreed. *Id.* at 15-17. The Court indicated that had access to the envelopes been content-neutral or had the PUC's order been narrowly tailored to serve a compelling state interest it would have been permissible. *Id.* at 13, 19.

The PaPUC submits that its order is in fact content-neutral and that Equitable has not been forced to take a position adverse to its own interest. The PaPUC's order in no way dictated what Equitable must say or do in FERC proceedings, merely that it operate independently of its affiliate Kentucky West in cases dealing with Kentucky West's rates or services.

In fact, in Equitable's most recent Act 74 proceeding, the PaPUC found, over OCA's objections, that the Company had been vigorously representing its customers' interests before the FERC. *Pennsylvania Public Utility Comm. v. Equitable Gas Co.*, 87 PUR 4th 131, 168 (1987). Although Equitable claims it will be forced to take positions with which it disagrees, experience has shown that this is not the case.

Even if Equitable's allegation were true, the PaPUC submits that its order is narrowly tailored to enforce a legitimate state interest. The PaPUC has merely directed that Equitable represent only its own interest or that of its customers rather than that of its sister company. The PaPUC's order will in no way prevent Kentucky West from advocating its own views before the FERC. Equitable Gas and Kentucky West are purportedly separate operating companies. That each should have separate counsel, in at least some proceedings, is well within the realm of reason and no hardship is created.

Kentucky West points out that parties such as the PaPUC and OCA can also appear at FERC to suggest that the PUC's order requiring separate counsel is unconstitutionally broad given the state interest to be protected. However, this argument essentially goes to the wisdom of the Pennsylvania General Assembly's mandate that *utilities* represent their customer's interests at FERC given that the OCA or PaPUC may also participate in a Kentucky West rate case. Petitioners attempt to add the *voluntary* efforts of OCA and the PaPUC at FERC to the *requirement* that Equitable represent itself in Kentucky West cases so as to make Act 74 an overly broad means of accomplishing a legitimate governmental interest. However, *Act 74* does not compel duplicative representation of ratepayers by OCA and PaPUC in Kentucky West cases.

E. Petitioners' Claims That They Have Been Denied the Right to Counsel and Due Process Rights With Respect to Free Speech Have Been Presented to This Court Prematurely

It is a general principle of law that federal courts will not take appeals where the order complained of has not adversely affected the complainant "but only affects his rights adversely on the contingency of future administrative action". *Hope*, *supra*, at 619; citation omitted. As stated above, although the instant order was issued by the PaPUC some three years ago Equitable Gas has not demonstrated that it has suffered any harm with respect to the PaPUC's direction to hire independent counsel. Until such time as it is able to demonstrate that it has been harmed, this issue is not ripe for review.

CONCLUSION

This Court should deny the Petition for a Writ of Certiorari for the reasons set forth above.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This will certify that completed copies of the Brief of Respondent, Pennsylvania Public Utility Commission in Opposition to the U.S. Supreme Court of the United States were forwarded this date, September 19, 1988 by First Class Mail.

Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
CLERK

(8)

No. 88-94

In The Supreme Court of the United States
October Term, 1988

Kentucky West Virginia Gas Company and
Equitable Gas Company, A Division of
Equitable Resources, Inc., Petitioners

v.

Pennsylvania Public Utility Commission and
Pennsylvania Office of Consumer Advocate,
et al.,
Respondents

Brief of Respondent Pennsylvania Office of Consumer Advocate in Opposition to Petition For a Writ of Certiorari to the United States Court of Appeals for the Third Circuit at Docket No. 87-5052

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QUESTIONS PRESENTED

1. Where the Petitioners failed to demonstrate in the district court below that a state ratemaking disallowance of imprudently incurred natural gas costs involved unavoidable federally approved "minimum bill" obligations, did the court of appeals err in determining that such a disallowance did not violate the supremacy clause of the United States Constitution?

2. Where a state statute codified longstanding public utility principles permitting the review and disallowance of imprudently incurred costs, did the court of appeals err in determining that the application of that statute did not result in an unconstitutional taking of the Petitioners' property without just compensation?

3. Where a state regulatory authority directed a gas distribution company to retain counsel which is independent of the counsel for the company's affiliated pipeline supplier, but did not otherwise restrict the company's choice of counsel or the positions to be taken by such counsel, did the court of appeals err in determining that such order did not violate Petitioners' due process or first amendment rights?

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No. 88-94

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY AND EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC., PETITIONERS

V.

PENNSYLVANIA PUBLIC UTILITY COMMISSION AND PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE, *ET AL.*,
RESPONDENTS

BRIEF OF RESPONDENT PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AT DOCKET NO. 87-5052

Respondent, Pennsylvania Office of Consumer Advocate ("OCA"), which is authorized by the laws of the Commonwealth of Pennsylvania to represent the interests of Pennsylvania utility consumers, Pa. Stat. Ann. Tit. 71, § 309-4(a) (Purdon 1988), submits this Brief In Opposition To The Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit At No. 87-5052. The OCA submits that the Petition should be denied as it raises no "special and important" reasons which would justify review by this Honorable Court.

STATEMENT OF THE CASE

The OCA adopts the Counter-Statement of the Case set forth by the Pennsylvania Public Utility Commission ("PUC") in its Brief in Opposition to the Petition for a Writ of Certiorari in this case.

The OCA rejects as incomplete or inaccurate certain contentions in the Statement of the Case submitted by the Petitioners, Kentucky West Virginia Gas Company and the Equitable Gas Company (hereinafter referred to jointly as "Kentucky West" or "Petitioners," unless a distinction is drawn between the two companies).

Most importantly, Kentucky West states at page 7 of its Petition — and indeed bases its entire Petition on the assertion that — *"even if Equitable had purchased gas from another supplier, the FERC-approved tariff required it to pay Kentucky West's minimum bill."* (Emphasis in the original). It is this very assertion of fact which the court of appeals found to have been completely unproven by Kentucky West in the district court below. App., *infra* p. 21a.

Moreover, Kentucky West's statement omits any reference to its opportunity to avoid its "minimum bill" payments by taking deliveries of such volumes at a later time pursuant to a FERC approved Settlement Order. *Kentucky West Virginia Gas Co.*, 33 F.E.R.C. ¶ 61,240 (November 15, 1985). While Kentucky West admits in its Statement that it invoked a *force majeure* defense to avoid the payment of certain minimum bill charges, it fails to add that, as the court of appeals has confirmed, it actually paid no such minimum bill charges during the period at issue. Petition at 6 n.6; App., *infra* p. 35a. Thus, Kentucky West's statement that the FERC tariff "required it to pay the minimum bill" does not consider its own *force majeure* defense and its failure to make such payments during the

period at issue. Nor does the Statement take into account the subsequent FERC Settlement Order which revised retrospectively Equitable's obligations pursuant to the Kentucky West tarriff.

The Statement also fails to mention a subsequent Order of the PUC which ultimately allowed Equitable to recover $2,552,833 in minimum bill obligations. *Pennsylvania Public Utility Commission v. Equitable Gas Co.*, Docket No. R-870589, 87 P.U.R.4th 131, 136-39 (August 31, 1987). This $2.5 million minimum bill award represented all of Equitable's minimum bill claim asserted in that case.

Kentucky West's statement also does not completely review the decisions of the district court and the court of appeals on the minimum bill issue. Petition at 8-9. The district court found that the Kentucky West tariff contained a "minimum commodity" bill but decided that, given the presentation of the facts in the case, Equitable was not bound to incur the $14.3 million of gas costs at issue under the terms of the "minimum commodity bill." App., *infra* p. 45a, 53a, 54a. The court of appeals similarly found that Kentucky West had not presented sufficient facts to prove its minimum bill case. App., *infra* p. 21a, 35a, 36a.

The OCA submits that the fundamental factual premise upon which the present Petition is based was not proven by Kentucky West at trial and is, indeed, an incomplete portrayal of the actual events as they transpired in this case.

REASONS FOR DENYING THE PETITION

A. Standards For Certiorari

Supreme Court Rule 17, like Rule 19, the rule it superceded, gives this Court complete discretion in deciding whether to grant or deny a petition for a writ of certiorari. Under Supreme Court Rule 17.1, further review on certiorari is available only where the Court determines that "there are special and important reasons" for granting the petition. Sup. Ct. R. 17.1.

In the Petition for a Writ of Certiorari now before this Court, Kentucky West presents three "reasons for granting the petition." Each of the "reasons" alleges that the court of appeals decision below improperly decided specific questions of constitutional law. As discussed below, Kentucky West has mischaracterized or exaggerated the significance of the issues decided below. When the true issues of the case are seen in a focused perspective, no "special and important reasons" exist for granting the instant Petition for a Writ of Certiorari.

B. This Court Should Not Grant Certiorari As The Facts Presented Indicate That The Filed Rate Doctrine Has Not Been Violated.

1. Kentucky West Has Failed To Develop Upon The Record At Trial The Facts Necessary To Review Its "Minimum Bill" Claim.

In Kentucky West's Petition, it seeks to invoke the authority of this Court to overturn the decision of the court of appeals based upon the "minimum bill" argument which the

court of appeals has ruled Kentucky West "failed to advance...for recovery at trial."[1] Petition at 14-15; App., *infra* p. 23a. Indeed, Kentucky West has abandoned the broad range of constitutional issues which addressed the PUC's "core authority" to review Equitable's gas purchasing policies in favor of this one specific claim. App., *infra* p. 3a, 20a; Petition at 9, 11 n. 11. As the "minimum bill" issue was not properly raised before the district court, this Court should not exercise its discretion to grant a writ of certiorari to consider Kentucky West's contention.[2]

The court of appeals specifically reviewed Kentucky West's failure to raise this issue and stated:

> In conformity with our power of plenary review, we undertook a time-consuming analysis of the proceedings below to ascertain whether Equitable had raised the question of its minimum bill obligation in the context now developed on appeal. We conclude that Equitable failed to provide an analytic framework supporting an argument that the $14.3 million disallowance represented an unavoidable FERC-approved contractual obligation. The record simply does not demonstrate that any portion of the disallowed

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[1]Kentucky West argues in a footnote that the FERC has also supported its minimum bill argument in FERC's brief submitted to the court of appeals. Petition at 16 n.14. However, Kentucky West fails to indicate that FERC took no position as to whether a minimum bill issue was implicated in this litigation as it declined to take any "position on the factual basis for that claim...." FERC C.A. Brief at 45, *Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Commission*, 837 F.2d 600 (3rd Cir. 1988).

[2]Kentucky West attempts to explain its failure to quantify at trial its minimum bill liability related to the purchases disallowed by stating in a footnote "Of course, Equitable was not seeking relief with respect to its minimum bill obligation generally, but only with respect to the cost of federally required purchases actually made and paid for."

(Footnote continued on following page)

costs represented Equitable's minimum bill obligation.

* * * *

. . .no minimum bill payments had ever been made to Kentucky West by Equitable, and the likelihood that such payments would ever be made was too speculative and uncertain to justify inclusion of them in Equitable's estimated cost of service. Those findings were unchallenged before the district court, and the first finding above was affirmed by the Pennsylvania Commonwealth Court. Therefore, this record cannot support an inference that the costs were unavoidable.

App., *infra* p. 21a, 35a-36a.

Despite this ruling by the court of appeals, Kentucky

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Petition at 18 n. 16. This statement fails to recognize that Kentucky West had the same opportunity to assert the "minimum bill" defense at trial that it later asserted before the court of appeals. This attempted explanation highlights the fact that Kentucky West has revised its litigation strategy and presented in its certiorari petition an issue not advanced at trial.

Equitable did not demonstrate at trial that it had incurred any Kentucky West "minimum bill" payments because it mischaracterized its "minimum bill" tariff obligation in the district court. Its Complaint stated: "These [FERC approved pipeline gas supply] contracts also include 'minimum bill' provisions which require Equitable to purchase a minimum specified percentage of its total contractual entitlement." C.A. App. at 16. This misstatement also appears in the Petition for Certiorari where Kentucky West states "the PUC's opinion never mentions the fact that the disallowed costs were incurred in satisfying a FERC-imposed duty to purchase gas from Kentucky West and pay the tariff rate for that gas." Petition at 17. The district court held that, while a minimum commodity bill may require *payment* for gas not taken, it "does not require Equitable to physically take the gas paid for." App., *infra* p. 45a. The associated argument that the "minimum bill" provision required payment even if no gas was taken was not further developed at trial.

West has converted its minimum bill argument into the central premise upon which its Petition is based. That is, Kentucky West first asks this Court to *assume* that the costs at issue here were unavoidable minimum bill obligations and then asserts that such a disallowance violated the "filed rate" doctrine. Even if this Court were to agree that such an issue would be worthy of review if properly presented, the issue should not be reviewed *in this proceeding* given Kentucky West's failure to properly raise the issue below.

The court of appeals acted well within its authority in declining to consider issues not properly advanced in the trial court. Where a party deliberately chooses to limit its factual presentation at trial to a particular issue in an effort to declare a state statute unconstitutional, that party is bound by the choices made and this Court will not consider other issues. *Brown v. Thomson,* 462 U.S. 835, 846 n. 9 (1983). *See also, Singleton v. Wulff,* 428 U.S. 106, 120 (1976); *Cardinale v. Louisiana,* 394 U.S. 437, 439 (1969).

Adherence to such a rule is particularly appropriate here, considering the complex minimum bill issue now asserted by Kentucky West. The effect of the minimum bill must be considered in light of the FERC approved Settlement Order of November 13, 1985 which modified Equitable's minimum bill obligation for the July 1, 1983 to July 31, 1984 time period. *See Kentucky West Virginia Gas Co.,* 33 F.E.R.C. ¶ 61,240 (1985). The Settlement Order also permitted Equitable to avoid in part its minimum bill payments for gas not taken during this period if later deliveries were taken during the January 1, 1985 through December 31, 1988 period. *Id.* at 61,498. Kentucky West did not provide evidence below to explain the actual effect of the minimum bill provisions and the November 1985 Settlement Order upon the PUC gas cost disallowance even though extensive trial proceedings oc-

curred in August 1986. C.A. App. at 344-902. Any belated excursion into fact finding before this Court is particularly inappropriate.

2. The Findings Of Fact Determined Below Do Not Support A Contention That The Filed Rate Doctrine Has Been Violated.

This Court has declared that it will exercise only limited appellate review when considering findings of fact. In this case, the district court found that the PUC had not disallowed any FERC approved costs which Equitable was required to pay to Kentucky West under the terms of its tariff. App., *infra* p. 53a-54a, 59a-60a. The court of appeals concurred, and found that there was no basis to assume the existence of any such "unavoidable" costs. App., *infra* p. 35a-36a. Thus, unless this Court wishes to engage in an independent fact finding mission, it is inappropriate to grant certiorari here.

This Court has determined that the findings of fact of a court of appeals shall not be reversed upon review by this Court. *National Labor Relations Board v. Pittsburgh Steamship Co.*, 340 U.S. 498, 503 (1951). "A court of law, such as this Court is, rather than a court for correction of errors in fact finding, cannot undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and exceptional showing of error. *Graver Mfg. Co. v. Linde Co.*, 336 U.S. 271, 275, 93 L.Ed. 672, 69 S.Ct. 535 (1949) [citation omitted]." *See also, Goodman v. Lukens Steel Co.*, 107 S.Ct. 2617, 2623 (1987); *Rudolph v. United States*, 370 U.S. 269, 270 (1962). Based upon the findings of fact made by the district court and court of appeals in the present case, *i.e.*, that there were no FERC approved costs that Equitable was bound to incur under the Kentucky West "filed rate," Kentucky West's minimum bill allegation dissolves for a lack of factual support.

Any remaining support for Kentucky West's claim is eroded by a later Order which granted to Equitable certain of its claimed minimum bill costs. In *Pennsylvania Public Utility Commission v. Equitable Gas Co.*, Docket No. R-870589, 87 P.U.R.4th 131, 138-39 (August 31, 1987), the PUC reviewed Equitable's minimum bill obligation in light of the FERC Settlement Order noted above. The PUC awarded Equitable an additional $2.5 million and found:

> The $2.5 million claimed in the instant proceeding is consistent with the FERC approved settlement, which permitted Kentucky West to waive the minimum commodity bill for the period involved in our 1985 Order.
>
> * * *
>
> Therefore, we will permit Equitable to include in rates that fixed cost portion of these gas volumes below minimum bill. This is consistent with our understanding of the operation of FERC approved minimum bills.

Id. at 139. No appeal was taken from this Order.

This Court has determined that the findings of administrative agencies should be given the same effect as such findings are given by state courts. *University of Tennessee v. Elliott*, 478 U.S. 788, 795 (1986). The court of appeals properly applied that doctrine in this case to give preclusive effect to the factual findings made in the 1985 PUC proceeding here at issue.[3] App., *infra* p. 22a. Apply-

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[3]Kentucky West asserts that the court of appeals "allows state regulators to immunize their prudence determinations from scrutiny by making the 'factual' finding that a FERC-approved tariff is not relevant...." in assessing the impact of a FERC rate. Petition at 18. Ken-

(Footnote continued on following page)

ing this same doctrine to the PUC's holding in the 1987 proceeding, which awarded Equitable $2.5 million in minimum bill costs, conclusively establishes that Equitable has been made whole with regard to its minimum bill costs.[4] Accordingly, this Court should accept the findings of fact below and rule, pursuant to Supreme Court Rule 17.1, that no controversy exists worthy of further review.

Given Kentucky West's failure to support its minimum bill claim in the trial court below, this Court cannot apply with any certainty the constitutional doctrines set forth in other cases involving FERC established rates such as *Mississippi Power & Light Co. v. Mississippi*, 108 S. Ct. 2428 (1988) and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986). Even if an important constitutional issue is implicated by a petitioner's allegations, "where the record is not sufficiently clear and specific" to decide the constitutional issue, the Court must decline to engage in such appellate review. *Massachusetts v. Painten*, 389 U.S. 560, 561 (1968). Accordingly, the facts of this case or, in the words of the court of appeals, "the absence of facts indicating that the specifics of this minimum bill obligation issue were properly presented to and adjudicated before the district court," creates an infirm founda-

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tucky West, however, misconstrues the court of appeals' finding. The court of appeals accepted the PUC finding of fact that Equitable had made no minimum bill payments to Kentucky West as a result of its *force majeure* defense and continued settlement discussions to determine "what minimum bill costs, if any, would *ever* be incurred by Equitable...." App., *infra* p. 21a. The court of appeals then considered this factual finding and determined, as a matter of law, that Equitable had no right to recover minimum bill costs not actually paid while settlement talks continued. App., *infra* p. 35a. Thus, the court of appeals accepted the PUC's determination only as a finding of fact and applied its own legal analysis to approve the PUC's conclusion.

[4]In a subsequent PUC proceeding, *Pennsylvania Public Utility Commission v. Equitable Gas Co.*, R-880932 (September 1, 1988), Equitable has sought an *additional* $10.2 million in costs which it

(Footnote continued on next page)

tion for the construction of any rule of constitutional law. App., *infra* p. 19a.

In *Mississippi* and *Nantahala*, this Court found that the obligation to pay the "trapped costs" under the FERC approved tariff was clear. In *Nantahala*, 476 U.S. 953 (1986), this Court concluded that the FERC Order at issue determined the amount of low cost power which Nantahala could obtain. *Id.* at 967. Similarly, in *Mississippi*, 108 S. Ct. 2428 (1988), FERC established the cost which Mississippi Power and Light was to pay to its power supplier. *Id.* at 2440. In *Mississippi*, this Court also acknowledged, however, that a refusal to pass through all wholesale costs might be permitted if the utility purchased "unnecessary quantities of high cost power, even at FERC approved rates, if it had the legal right to refuse to buy that power." *Id.; See also Nantahala*, 476 U.S. at 972 (citing *Pike County Light & Power v. Pennsylvania Public Utility Commission*, 77 Pa. Commw. 268, 273-74, 465 A.2d 735, 737-38 (1983)).

The Pennsylvania Commonwealth Court clarified this exception to the "filed rate" doctrine in *Pike County* as follows:

> The FERC focuses on Orange & Rockland to determine whether it is just and reasonable *for that company* to charge a particular rate, but makes no determination whether it is just and reasonable *for Pike to incur* such a rate as an expense.

* * *

(Footnote continued from previous page)
claims would have been due to Kentucky West if it had not taken the gas which is the subject of the 1985 gas cost disallowance. By Order entered September 1, 1988, the Commission rejected this claim on the ground that this "variable" portion of Equitable's minimum bill obligation was waived under the FERC Settlement Order noted above and that such obligation was never actually incurred. Slip Opinion at 5-13.

> The PUC focuses on Pike...to determine whether it is reasonable for Pike to incur such costs in light of available alternatives.

Id. at 274-75, 465 A.2d at 738 (emphasis in the original). The court of appeals held that Kentucky West failed to prove the existence of any unavoidable "trapped costs." App., *infra* p. 14a-23a. The disallowance of excessive gas costs in this case falls clearly within the *Pike County* exception to the filed rate doctrine which was implicitly recognized in *Mississippi,* 108 S. Ct. 2428 (1988), and *Nantahala,* 476 U.S. 967 (1986). Thus, no review by this Court pursuant to Supreme Court Rule 17.1(c) is required.

Moreover, this Court's recent discussions and applications of the filed rate doctrine in *Nantahala* and *Mississippi* do not require restatement here. This Court has explained the filed rate doctrine comprehensively in both of those cases. The factual limitations and ambiguities evident in this case do not present a reasonable opportunity for fruitful reexamination of the filed rate doctrine. Thus, the *Nantahala* and *Mississippi* cases do not require or support the need for further appellate review as the facts presented in this case do not establish that any violation of the filed rate doctrine has occurred.

3. The Filed Rate Argument In This Case Has Lost Importance Given FERC's Recent Policy Of Eliminating Minimum Bills From Pipeline Tariffs.

As indicated above, the gravamen of Kentucky West's Petition concerning the "filed rate" doctrine is dependent upon a finding that the Kentucky West tariff compelled Equitable to incur minimum bill costs related to all Kentucky West gas not taken. The importance of this issue has been diminished substantially by FERC's June 22, 1988 Order eliminating Kentucky West's minimum bill from the tariff under which Equitable takes service. The Kentucky

West minimum bill was eliminated retroactively as of March 2, 1986. *Kentucky West Virginia Gas Co.*, 43 F.E.R.C. ¶ 61,496, 62,228 (June 22, 1988). Request for Rehearing granted solely for the purpose of further consideration, *Id.* at Docket RP86-52-010, *et al.*, Order issued August 19, 1988.

The FERC has also, as a matter of general policy, eliminated minimum bills with regard to other major gas pipelines. In *Texas Eastern Transmission Corp.*, 43 F.E.R.C. ¶ 61,076 (April 19, 1988), it was noted that the FERC had eliminated minimum bills from a number of major gas pipeline tariffs in recent years.[6] Thus, the importance of minimum bill provisions upon the filed rate doctrine has diminished not only for Kentucky West but for the gas pipeline industry as a whole.

This Court has held that a writ of certiorari should be dismissed if circumstances have changed such that the issue presented is "intellectually interesting" but subsequent events have reduced its "importance to the public." *Rice v. Sioux City Memorial Park Cemetery*, 349 U.S. 70, 74, 79 (1955) (quoting from *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923)). Minimum bill provisions have now been almost entirely extinguished from FERC pipeline tariffs in the interest of fostering competition between pipelines. *Texas Eastern*, 43 F.E.R.C. at 61,237 and *Kentucky West*, 43 F.E.R.C. at 62,225. Even if this Court concludes that the minimum bill provisions of the Kentucky West tariff have raised a "filed rate" issue in this case, it is submitted that such an issue is now only of

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[6] *Id.* at 61,238 n.17 (citing *Transcontinental Gas Pipe Line Corp.*, 37 F.E.R.C. ¶ 61,328, Opinion No. 260 (1986); *ANR Pipeline Co.*, 37 F.E.R.C. ¶ 61,263, Opinion No. 258 (1986), reh'g denied, 38 F.E.R.C. ¶ 61,221, Opinion No. 258-A (1987); *Tennessee Gas Pipeline Co.*, 36 F.E.R.C. ¶ 61,071 (1986); and *Transwestern Pipeline Co.*, 32 F.E.R.C. ¶ 61,009, Opinion No. 238 (1985), reh'g denied, 36 F.E.R.C. ¶ 61,175, Opinion No. 238-A (1986)).

historical interest given FERC's recent policy of eliminating minimum bill provisions from pipeline tariffs. Thus, the "filed rate" issue which Equitable has attempted to present fails to raise an issue of continuing public importance appropriate for granting a writ of certiorari.

C. The PUC's Disallowance Of Imprudently Incurred Energy Costs Was Not Confiscatory.

1. The PUC Exercised Its Authority To Disallow Imprudent Energy Costs Prior To The Enactment Of Act 74.

The second of Kentucky West's "Reasons For Granting The Petition" is grounded in mistaken assumptions of law. Kentucky West asks this Court to consider whether the "retroactive application of a new ratemaking standard" which bars the recovery of costs they allege as "previously recoverable" constitutes a "taking of property without just compensation in violation of the Due Process Clause of the Fourteenth Amendment." Petition at I. Thus, it is Kentucky West's claim that Act 74 was a "new ratemaking standard" which, when applied to the gas purchases in question, violated the Constitution. Petition at 20.

The OCA submits that the underlying authority of the PUC to review the prudency of a public utility's energy cost rests not in the enactment of Act 74, but rather in the Commission's general authority, and corresponding obligation, to establish "just and reasonable rates." 66 Pa. Cons. Stat. § 1301 (1988). This authority existed long before Act 74 was enacted, and is essential in order for a state utility commission to determine fair utility rates. Such regulatory treatment has long been applied

by state commissions.[6] Accordingly, Kentucky West's claim concerning the "retroactive" application of Act 74 rests on a fundamentally ill-conceived notion of preexisting public utility law.

As explained by the Commission in the Order which gave rise to this proceeding, Act 74 established a specific statutory standard and procedural basis by which the recovery of gas costs could be judged. While the statute was enacted after Equitable incurred the gas cost that was disallowed in the PUC decision below, the authority to disallow such costs as imprudent was not a new concept to utility law. A review of prior energy cost cases demonstrates that the PUC correctly held that it had the "authority to disallow the pass-through of excess gas costs *even before Act 74 was established.*"[7] App., *infra* p. 134a (emphasis in the original).

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[6]*See, e.g., Re Lockport Light, Heat & Power Co.*, No. 4335, 1918C P.U.R. 675, 700-03 (N.Y.P.S.C. 1918) (utility was not allowed to recover the additional cost of electricity incurred by purchasing from an affiliate instead of under an existing contract with a less expensive supplier); *Re City of Vancouver v. Pacific Power & Light*, No. 5184, 1921C P.U.R. 527, 532-33 (P.S.C. Wash. 1921) (utility allowed to recover costs of purchasing gas from an affiliate where that gas was less expensive than available alternatives); *Re Village of Pardeeville v. Pardeeville Electric Light Co.*, No. 2-U-285, 10 P.U.R. (N.S.) 267, 269-71 (Wis. P.S.C. 1935) (utility not allowed to recover the costs of generating its own power where it would have been less expensive to purchase all of its requirements from an outside supplier); and, more recently, *Re Bozrah Light & Power Co.*, No. 9850, 34 P.U.R.3d 398, 406 (Conn. P.U.C. 1960) (utility reasonably purchased power through a middleman because it would have been more expensive to purchase energy directly from the supplier); and *Re Pacific Lighting Gas Supply Co.*, No. 43670, 44 P.U.R.3d 177, 183-86 (Cal. P.U.C. 1962) (utility imprudently chose to purchase more expensive gas from intrastate producers when cheaper, more reliable sources were available from interstate pipelines).

[7]Kentucky West also takes issue with the court of appeals' rejection of their retroactivity claim on the basis that the court of appeals found incorrectly that Equitable "voluntarily" chose the retroactive re-

(Footnote continued on next page)

Equitable raised the same ground for relief in a related case before the Commonwealth Court of Pennsylvania, which is the Pennsylvania intermediate court that hears all appeals of PUC Orders. The claim was unanimously rejected. *Equitable Gas Co. v. Pennsylvania Public Utility Commission*, 106 Pa. Commw. 240, 526 A.2d 823 (1987). The Commonwealth Court interpreted the authority of the PUC to review and disallow gas costs retrospectively as follows:

> [T]here was no retroactive application of Act 74 by the PUC because, prior to the enactment of Act 74, the PUC had the authority to retroactively determine the reasonableness of costs incurred in a subsequent proceeding. The authority to determine reasonableness was not limited to prospective application of Act 74 in the case at bar because the rates in issue had yet to be subject to a determination by the PUC as to their reasonableness as required by Section 1301 of the Public Utility Code.

(Footnote continued from following page)

view standard when it filed for an upward gas adjustment pursuant to 66 Pa. Cons. Stat. 1307(f) (1988). Petition at 23. The court below, however, was correct that Equitable had a legitimate choice of filing under either the Section 1307 gas cost standard or the base rate procedures under Section 1308 of the Public Utility Code. The Section 1308 proceeding sets rates prospectively, not retrospectively, based on projections of the future cost of gas. *See* 66 Pa. Cons. Stat. §§ 1308 and 1318 (1988). However, Section 1308 does not provide for the retrospective review of fuel cost recovery as provided for by Section 1307. Thus, Equitable could have elected to have its gas costs recovered through a Section 1308 proceeding prior to the 1983-1984 period here at issue which would not have been subject to the retroactive disallowance of which they now complain.

Id. at 262, 526 A.2d at 832.[8]

Moreover, the PUC asserted its authority to disallow from rates excessive gas and other energy costs well before the enactment of Act 74. For example, in *Gas Cost Rate No. 6,* M-78050055F083 (Pa. P.U.C. January 13, 1984) which was cited by the PUC in its decision below and which applied to all Pennsylvania jurisdictional gas utilities, the PUC stated:

> Until an appellate court holds that Section 1307 procedures do not permit this Commission to retroactively adjust fuel cost rates we will continue to review prior Gas Cost Rates retrospectively and comprehensively. We will exercise our power of review for the purposes of determining not only the arithmetic accuracy of the fuel costs incurred and billed, but also the reasonableness of those charges.
>
> * * *
>
> We not only reserve the right, but also specifically condition the granting of approval of GCR No. 6 (or any automatic fuel cost adjustment tariff) on the ability or power of this Commission to retroactively investigate, audit and adjust the reasonableness of the rates set herein as contemplated by the express wording of subsection 1307(e)(2).

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[8]Although the decision of a lower state court is not controlling on an issue on which the highest state court has not spoken, this Court attaches significant weight to a lower state court's decision in the absence of convincing evidence that the highest state court would rule otherwise. *See Commissioner v. Estate of Bosch,* 387 U.S. 456, 464-65 (1967); *West v. American Telephone & Telegraph Co.*, 311 U.S. 223, 237 (1940). Thus, this Court should accept the Commonwealth Court's interpretation of Act 74 and the PUC's preexisting authority to disallow imprudently incurred fuel costs.

App., *infra* p. 134a-35a (quoting Gas Cost Rate No. 6, M-78050055F083 (Pa. P.U.C. January 13, 1984)). Indeed, the *Gas Cost Rate No. 6* Order was itself a reaffirmation of the Commission's 1978 Order which established the gas cost rate procedure and stated that:

> The application of the gas cost rate shall be subject to continuous review and to audit by the commission at such intervals as the commission shall determine. The commission shall continuously review the reasonableness and lawfulness of the amounts of the charges produced by the gas cost rate and charges included therein.

Re Gas Cost Rates, 52 Pa. P.U.C. 217, 220 (1978).

The PUC's pre-existing authority to disallow the costs at issue here is also evidenced by the holdings in *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 77 Pa. Commw. 268, 465 A.2d. 735 (1983) (affirming *Pennsylvania Public Utility Commission v. Pike County Light & Power Co.*, 56 Pa. P.U.C. 371 (1982)); *Allegheny Ludlum Steel Corp. v. Pennsylvania Public Utility Commission*, 501 Pa. 71, 459 A.2d 1218 (1983) (affirming PUC Order entered January 1, 1982); and *Metropolitan Edison Co. v. Pennsylvania Public Utility Commission*, 62 Pa. Commw. 460, 437 A.2d 76 (1981) (affirming PUC Order entered May 23, 1980).

The PUC, in *Metropolitan Edison*, 62 Pa. Commw. at 468, 437 A.2d at 81, had determined "that as a result of Met-Ed's managerial imprudence, the utility's ratepayers were forced to pay, in 1974, unjust and unreasonable rates under Met-Ed's fuel adjustment clause." The Commonwealth Court, in affirming the PUC's disallowance of those imprudent costs, rejected the utility's contention that a provision in its tariff which allowed the company to adjust its rates to reflect fuel costs "represents a 'Commission-

made rate' and thus cannot be retroactively changed" by the PUC. *Id.* at 465, 437 A.2d at 79. The Commonwealth Court reasoned that, while commission-made rates were "stamped with antecedent Commission approval" and thus "immune from retroactive alteration," the rates in question had not been subject to such prior approval by the Commission and "thus, Met-Ed could not validly expect that the surcharges in issue were insulated from retroactive modification by the Commission." *Id.*, 437 A.2d at 79-80.[9]

Most significantly, in *Pike County,* 56 Pa. P.U.C. at 373, the PUC determined in 1982 that it had the authority to consider the reasonableness of a subsidiary's power supply expenses, even though such expenses were paid pursuant to a FERC tariff over which the Commission recognized that it had no jurisdiction. The Commission's decision in *Pike County* was guided, however, by its conclusion that the FERC tariff sets the *rate* for purchasing wholesale energy, but does not prevent a utility from exercising reasonable judgment in its *choice* of purchasing among available alternative sources subject to other FERC rates. *Id.* Moreover, the Commission noted that "it is within our power to determine the reasonableness of expenses incurred by Pike." *Id.* at 372. These determinations were upheld in 1983 by the Pennsylvania Common-

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[9]*See also, Allegheny Ludlum,* 501 Pa. 71, 459 A.2d 1218 (1983), where the Supreme Court of Pennsylvania reviewed and upheld as constitutional the PUC's implementation of an energy cost rate adjustment provision of the Public Utility Code similar to the Act 74 mechanism. The Court determined that retrospective prudency review of electric power cost increases satisfied procedural due process requirements because the mechanism provided procedural "safeguards ... afforded through a subsequent, year end, automatic proceeding for final determination and adjustment of rate increases allowing full participation by all interested parties." *Id.* at 77, 459 A.2d at 1221.

wealth Court in *Pike County,* 77 Pa. Commw. 268, 465 A.2d 735 (1983).[10]

The purchases disallowed in *Pike County,* 56 Pa. P.U.C. at 373, were substantially similar to the affiliate purchases disallowed by the Commission in its decision at issue in the present case. Pike County had purchased more expensive electric power from its parent company when less expensive power was available. Act 74 clearly did not create the PUC's authority to disallow such costs, since such authority has already been exercised pursuant to the Commission's pre-existing duty to set just and reasonable rates. Thus, the Pennsylvania courts have long held that imprudently incurred energy costs are subject to an after the fact disallowance.

2. The Commission's Denial Of Gas Costs That Were Found To Be Imprudently Incurred Did Not Violate Reasonable Investor Expectations.

A state utility commission has the authority — and indeed, the duty — to disallow a utility's attempt to recover excessive, uneconomical, or imprudently incurred expenses. Kentucky West's assumptions concerning applicable state law and this Court's takings jurisprudence are fundamentally erroneous.

Kentucky West's claim that the Commission Order here violated reasonable investor expectations is thus without merit. Petition at 21. This Court has recognized that investor expectations based on inaccurate interpreta-

[10]As noted above, the *Pike County* decision was distinguished by this Court as a possible exception to the filed rate doctrine in *Nantahala,* 479 U.S. at 972. *See infra p. 11.* In addition, the court of appeals, in its decision that the district court should not have abstained from addressing the merits of this case, referenced *Pike County* when it stated that Act 74 is "in our opinion, not only clear on its face, it is also consistent with prior Pennsylvania case law on this topic." App., *infra* p. 93a.

tions of the law are not protected by the takings clause. See *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005-10 (1984); *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 161 (1980) ("[A] mere unilateral expectation or an abstract need is not a property interest entitled to protection"). To the extent that investors believed that Equitable had a constitutional right to recover imprudent expenses from ratepayers, they were clearly mistaken. As a matter of longstanding public utility law and particularly in light of the 1982 PUC and 1983 Commonwealth Court decisions in *Pennsylvania Public Utility Commission v. Pike County Light & Power Co.*, 56 Pa. P.U.C. 371 (1982) and *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 77 Pa. Commw. 268, 465 A.2d 735 (1983), it should have been clear to those investors that the Company's decisions to purchase expensive gas from an affiliate while lower cost gas was available from other sources, would not be immune from Commission scrutiny. Nor should those investors have been surprised when that scrutiny resulted in this partial rate disallowance.

In *Equitable*, 106 Pa. Commw. at 261, 526 A.2d at 832, the Commonwealth Court recognized the PUC's authority to disallow these costs and stated: "It is an underlying principle of public utility law that a utility may not recover costs from its ratepayers unless those costs have been determined to be just and reasonable," and that: "As these costs were found by the PUC to be excessive and imprudently incurred, and therefore unreasonable, the PUC could properly disallow the pass through of these costs to ratepayers."[11]

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[11]Kentucky West also claims that the PUC previously approved Equitable's purchasing strategy in its *Re Gas Cost Rate No. 5*, No. M-78050055, 58 P.U.R.4th 369, 375 (Pa. P.U.C. March 16, 1984) proceeding. Petition at 6. However, Kentucky West admits that this approval applied only to "the period immediately preceding that at issue here." *Id.* Moreover, the actual holding of the *GCR No. 5*

(Footnote continued on following page)

Kentucky West's confiscation claim is, therefore, without merit as investors could have no reasonable expectation of the recovery of imprudently incurred costs.

D. The PUC's Requirement That Equitable Must Employ Separate Counsel From That Employed By Kentucky West For FERC Rate Proceedings Did Not Violate The Due Process And The First Amendment Constitutional Rights Of Equitable.

The PUC Order at issue recognized an inherent conflict presented in Equitable's participation in the Kentucky West rate cases before the FERC. Equitable and Kentucky West are affiliated companies within the corporate structure of Equitable Resources, Inc. App., *infra* p. 147a. Equitable purchases more than 70% of all gas sold by Kentucky West. *Id.* Noting this conflict, the PUC entered an Order requiring that Equitable "obtain independent representation of its interest by legal counsel and technical support staff wholly separate from Kentucky West...." App., *infra* p. 148a.

Kentucky West took issue with this aspect of the Order and sought its reversal in the district court on the

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proceeding that Kentucky West references in support of its notion of prior approval is inapposite to its claim. *Re GCR No. 5* , 58 P.U.R.4th at 369. As noted by the PUC in its decision below, App., *infra* p. 135a, it "expressly held [in *GCR No. 5*] that all fuel revenues and expenses, whether in the GCR or in base rates, are subject to review within the Commission's GCR procedures and are not Commission-made rates." *See GCR No. 5*, No. M-78050055, 58 P.U.R.4th 369, 375 (Pa. P.U.C. March 16, 1984). The Commission also noted: "[i]n addition, the issues raised by Trial Staff and the OCA here were not actually litigated in *GCR No. 5.*" App., *infra* p. 135a-36a. Thus, the prudency of Equitable's purchased gas costs and practices during the period involved here was not litigated or even considered in *GCR No. 5.*

grounds that it had been denied the right to due process and other first amendment guarantees under the U.S. Constitution. App., *infra* p. 43a n.4. The district court took no action upon this claim, ruling that it may more properly be submitted to the FERC at a later time. *Id.*

Upon Kentucky West's appeal of the district court decision, the court of appeals reviewed the Kentucky West claim, recognized the potential conflict of interest between Equitable and Kentucky West and held that the PUC Order did not contravene any principle of federal law. App., *infra* p. 36a-39a.

In its Petition, Kentucky West argues broadly that the PUC has violated its right to unrestricted choice of legal counsel and references such concepts as "fundamental fairness," "Anglo-American Legal tradition," "due process," and "First Amendment Rights." Petition at 24-26. Kentucky West seeks to expand preexisting law concerning the right to counsel in administrative proceedings into an absolute doctrine unaffected by the actual conflicts of interest evident in this case.

As the court of appeals has concluded, the right to choice of counsel is not absolute. App., *infra* p. 38a. Federal courts have recognized that important policies may restrict a litigant's choice concerning the selection of counsel. In *Federal Trade Commission v. Exxon Corp.*, 636 F.2d 1336, 1341-47 (D.C. Cir. 1980), it was held that the Federal Trade Commission acted within its authority in prohibiting an attorney-client relationship between the Exxon corporate parent and the Drives Group subsidiary, given the potential for FTC ordered divestiture of these two entities. *Exxon* indicates that the FTC Order did not inhibit Exxon's ability to continue its litigation and that a potential conflict of interest existed between Exxon and the Drives Group. *Id.* at 1342, 1345-47. Given the important policy goal of making certain that the integrity of the

Drives Group could be protected in the event that divestiture was ordered, the Court approved the FTC Order which categorically prohibited Exxon and Drives Group from sharing the same attorney. *Id.*

The right to counsel may be restricted when important policy goals require such restrictions. Notably, in this case, a clear conflict of interest between Kentucky West and Equitable was evident which provided a similar basis for the restriction on counsel selection as existed in *Exxon*. *Id.* at 1336. While Equitable and Kentucky West are entirely free to choose among the large body of lawyers qualified to represent them before the FERC, they are not permitted to employ the same attorneys in consideration of the policy of avoiding conflicts of interest as set forth above.

Kentucky West cites frequently the case of *Walters v. National Association of Radiation Survivors*, 473 U.S. 305 (1985), in order to buttress its right to counsel argument. In *Walters*, a group of veterans sought to establish a constitutional right to attorney representation before the Veterans Administration. This right had allegedly been violated by a federal statute restricting payment to attorneys in such cases. *Id.* at 332-34. The creation of an additional constitutional right to attorney representation was flatly rejected by this Court. In *Walters*, it was found that such an unrestricted right to attorney representation did not attach to the administrative proceedings related to the securing of veterans' benefits. *Id.* at 332-35.

As the court of appeals determined in this case, this Court has not recognized an absolute constitutional right to counsel in a civil case or in a civil matter before an administrative agency. App., *infra* p. 37a-38a. The court of appeals correctly distinguished a case securing a party's right to joint counsel before an administrative agency, *i.e.*, *SEC v. Higashi*, 359 F.2d 550, 553 (9th Cir. 1966), as involving a right to the joint use of counsel where each of the parties

shared potential common liability in the case prosecuted by the administrative agency. Kentucky West and Equitable have made no contention here that they share common potential liability before the FERC. Hence, *Higashi* may be distinguished upon its facts.

Kentucky West seeks to support its right to counsel argument by exaggerating the effect of the PUC Order as follows: "In other words, the order forces Equitable to make statements, through independent counsel acting on behalf of the ratepayers, with which it does not agree." Petition at 27. While the PUC's Order compels Equitable to hire counsel "fully separate from Kentucky West," the Order does not require Equitable to make statements or take positions "with which it does not agree."

The PUC's subsequent Order in 1987 demonstrates that the PUC has not compelled Equitable to take any particular positions before the FERC. The PUC's opinion quotes with approval the Recommended Decision of the Administrative Law Judge which states that "'the Company does have the right to exercise its own management discretion'" concerning the positions advocated before FERC. *Pennsylvania Public Utility Commission v. Equitable Gas Company,* Docket No. R-870589, 87 P.U.R.4th 131, 168 (Pa. P.U.C. August 31, 1987). The PUC has not attempted to impose any particular litigation strategy or positions upon Equitable concerning its litigation before the FERC. Accordingly, Kentucky West's contention that the PUC forced it to act against its own interest in violation of its First Amendment constitutional rights is clearly incorrect.

Moreover, this entire controversy is not ripe for review. Equitable has in fact hired a second law firm to represent it in all Kentucky West proceedings. *Id.* at 164. No showing has been made upon this record that Equitable has been harmed in any manner by the use of such a second firm in Equitable's litigation with its affiliate. The

PUC has also not attempted to censor or in any manner direct Equitable to advocate positions before the FERC with which it disagrees. Thus, the issue presented is the type of "abstract disagreement" which this Court has determined would not be ripe for review. *See Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 580-81 (1985). The case does not present the type of conflict necessary to fully decide a constitutional issue such as the one advocated in this proceeding.

CONCLUSION

The Court of Appeals for the Third Circuit correctly determined that the PUC Order at issue did not 1) violate the "filed rate" doctrine, 2) improperly impose a new standard for the disallowance of imprudently incurred gas costs, or 3) deny to Equitable its constitutional rights by requiring Equitable to employ counsel separate from that employed by Kentucky West. The court of appeals rulings are not inconsistent with prior rulings of this Court or with the rulings of other federal courts of appeal. No important and unresolved issues of federal law are presented. Therefore, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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No. 88-94

In the Supreme Court of the United States

OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY, ET AL.,
PETITIONERS

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether the refusal of respondent, a state public utility commission, to allow one of the petitioners to recover costs incurred pursuant to a contract for the purchase of natural gas from an affiliated company, violated the "filed rate doctrine" because the purchase contract had been approved by the Federal Energy Regulatory Commission and respondent's determination that less expensive sources of gas were available did not adequately consider the legal significance of the contract's minimum bill provision.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-40a) is reported at 837 F.2d 600. The prior opinion of the court of appeals (Pet. App. 80a-95a) is reported at 791 F.2d 1111. The opinion of the district court (Pet. App. 41a-79a) is reported at 650 F. Supp. 659. The prior opinion of the district court (Pet. App. 96a-104a) is reported at 620 F. Supp.

1458. The order of the Pennsylvania Public Utility Commission (Pet. App. 107a-163a) is unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 105a) was entered on January 19, 1988, and a petition for rehearing was denied on February 16, 1988 (Pet. App. 106a). Pursuant to orders issued by Justice Brennan, the time within which to file a petition for a writ of certiorari was extended to and including July 15, 1988, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Pursuant to the Natural Gas Act, 15 U.S.C. 717 *et seq.*, the Federal Energy Regulatory Commission (FERC) is responsible for ensuring that all rates and charges of natural gas companies for or in connection with the transportation or sale of natural gas in interstate commerce are "just and reasonable" (15 U.S.C. 717c(a)). Natural gas companies are required to file with FERC schedules setting forth all rates and charges for any transportation or sale within FERC's jurisdiction (15 U.S.C. 717c(c)).

Petitioner Kentucky West Virginia Gas Company (Kentucky West), an interstate pipeline, is one of three principal suppliers of natural gas to its affiliate Equitable Gas Company (Equitable), a company engaged in retail distribution of natural gas to consumers in Pennsylvania and in other states (Pet. App. 3a-4a). FERC has approved the terms of the contract entered into between Equitable and Kentucky West (*id.* at 4a), including both the rates at which Equitable purchases the natural gas and a "minimum

commodity bill" provision, which requires Equitable "to pay the full commodity charge for [the] minimum volume of gas regardless of whether Equitable actually needs or wants the gas" (*id.* at 45a (footnote omitted)). The contract also includes a *force majeure* clause, which Equitable invoked on June 30, 1983, when it reduced its purchases effective July 1, 1983, to volumes below minimum bill levels and informed suppliers, including Kentucky West, that Equitable would pay only for gas taken (*id.* at 148a).

In March 1985, Equitable filed a request with respondent, the Pennsylvania Public Utility Commission (PUC), for a rate increase to recover the amount by which its actual costs had exceeded its revenues during the period from July 1983 through December 1984 (Pet. App. 109a, 132a-143a). The PUC granted Equitable's request for a rate increase, but adjusted downward the level of the increase (*id.* at 142a-143a, 162a). The PUC's adjustment denied Equitable the right to recover approximately $14.3 million in previously-incurred costs (*id.* at 46a).

The PUC cited as authority for its decision both its inherent authority to disallow the pass-through of imprudently incurred costs (Pet. App. 134a), and a recently-enacted state statute barring the PUC's approval of a proposed tariff in the absence of a showing that "the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers" (Pa. Cons. Stat. Ann. § 1318(a) (Purdon Supp. 1988); see Pet. App. 4a-5a n.1). The PUC explained that it agreed with the Office of Consumer Advocate and the PUC's Trial Staff that Equitable should not be entitled to recover all of its excess

costs during the relevant period because it had purchased gas from Kentucky West at a price substantially higher than that available from other sources of gas (Pet. App. 142a-143a). The PUC rejected Equitable's claim that its purchases from Kentucky West were justified because it needed "to reduce the quantity of excess gas supply on its system," or alternatively, because "any gas not taken from a pipeline supplier is lost to Equitable" (*id.* at 137a-138a; see *id.* at 139a-140a). The PUC also rejected Equitable's argument that "its production takes resulted in lower net costs given its minimum commodity bill liability from its pipeline suppliers" (*id.* at 140a). The PUC described how the Office of the Consumer Advocate had "point[ed] out that Equitable has never demonstrated on this record that the shutting-in of local production and local purchases of gas was cost justified in relation to the minimum commodity bill liability which it would have incurred had it continued to take local production and local purchases of gas supply while cutting back on its pipeline takes" (*ibid.*).

Finally, the PUC rejected Equitable's contention that FERC's approval of its contract with Kentucky West preempted any authority on the part of the PUC to deny Equitable complete recovery of its costs (Pet. App. 143a-145a). Relying on *Pike County Light & Power Co.* v. *Pennsylvania Public Utility Comm'n*, 77 Pa. Comw. 268, 274-275, 465 A.2d 735, 738 (1983), the PUC concluded that it could "examine Equitable's purchased gas costs incurred and deny the collection of any excessive affiliated costs incurred in light of other available alternatives," without taking any action inconsistent with FERC's determination of the justness and reasonableness of the contract (Pet. App. 145a).

2. The district court upheld the PUC's determination (Pet. App. 41a-79a).[1] The court rejected petitioners' claim that a contrary result was compelled by *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), in which this Court held that state regulatory authorities may not establish retail rates for electric power based upon an allocation of low-cost hydroelectric power different from that established by FERC (Pet. App. 53a-54a). According to the district court, in this case, unlike in *Nantahala*, "[n]o single entity, simultaneously serving as wholesaler and retailer, is subject to the potential of conflicting orders from federal and state agencies. There is accordingly no risk of 'trapped costs' and the filed rate doctrine is inapplicable here." Pet. App. 53a. Moreover, the district court further explained, in *Nantahala* the Court had explicitly assumed that "a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive" where "lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable *price*" (Pet. App. 54a (quoting 476 U.S. at 972 (emphasis in original)); see also Pet. App. 63a).[2]

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[1] The district court initially dismissed the complaint on the ground that abstention was appropriate under *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943) and *Younger* v. *Harris*, 401 U.S. 37 (1971) (see Pet. App. 96a-104a), but the court of appeals reversed and ordered the district court to consider the case on the merits (see *id.* at 80a-95a).

[2] The district court also rejected petitioners' Commerce Clause and equal protection claims (see Pet. App. 64a-75a, 75a-78a). The court declined to rule on petitioners' due process claim (see *id.* at 69a n.14).

3. The court of appeals affirmed (Pet. App. 1a-40a). The court agreed with the district court that *Nantahala* "in no way undermines the long-standing notion that a state commission may legitimately inquire into whether the retailer prudently chose to pay the FERC-approved wholesale rate of one source, as opposed to the lower rate of another source" (Pet. App. 17a). The court also found no conflict between FERC's authority and that exercised by the PUC in this case because "the question here of whether the retailer acted with economic prudence in purchasing from one wholesaler rather than another is never before FERC" (*id.* at 18a).

The court of appeals likewise rejected petitioners' claim that the PUC's $14.3 million disallowance was impermissible because that amount "represented fixed and unavoidable costs incurred by the company * * * pursuant to its minimum bill contractual obligation with Kentucky West" (Pet. App. 18a-19a (footnote omitted)). The court agreed with Equitable that it was probably beyond the power of the PUC to decide "that Equitable should not have purchased gas from Kentucky West in favor of less expensive supplies without regard to the fact that Equitable would have had to pay for the gas in any event under the minimum bill contract" (*id.* at 19a). Nonetheless, after "a time-consuming analysis of the proceedings below," the court of appeals "conclude[d] that Equitable failed to provide an analytic framework supporting an argument that the $14.3 million disallowance represented an unavoidable FERC-approved contractual obligation. The record simply does not demonstrate that any portion of the disallowed costs represented Equitable's minimum bill obligation." *Id.* at 21a. The court also explained that Equitable's in-

vocation of the *force majeure* clause on June 30, 1983, created "uncertainty as to what minimum bill costs, if any, would *ever* be incurred by Equitable" and thus further "justified the PUC's refusal to consider minimum bill liability in evaluating whether Equitable had pursued a least cost fuel procurement policy for the twelve month period under examination" (*ibid.* (emphasis in original)).[3]

ARGUMENT

Petitioners' disagreement with the court of appeals' ruling, whatever its merit, concerns a narrow and essentially factbound matter that does not warrant plenary review by this Court.[4] Nor does this Court's intervening decision in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), add anything sufficiently new to the legal principles applied by the court of appeals to warrant this Court's

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[3] Like the distirct court (see note 2, *supra*), the court of appeals rejected petitioners other claims for relief, including their contentions that the PUC had violated the Commerce Clause, and had deprived Equitable of its due process, "right to counsel," and discovery rights (see Pet. App. 23a-33a, 33a-36a, 36a-39a, 39a-40a).

[4] Although FERC is nominally a party in this case, it did not actively participate in the district court and participated only in a limited fashion in the court of appeals (see Pet. App. 8a n.4 ("The Federal Energy Regulatory Commission is a named defendant, but their position is more akin to that of an amicus."). FERC there addressed petitioners' preemption theory in general terms, without taking a formal position on the minimum bill issue (see Pet. 16-17 n.14). Because FERC did not address petitioners' takings or due process arguments in the court of appeals, we address here only the question whether petitioners' preemption claim warrants further review.

granting the petition for the limited purpose of vacating the judgment and remanding the case for reconsideration in light of that decision. The petition therefore should be denied.

1. The scope of petitioners' dispute with the court of appeals' decision is extremely narrow. For their part, petitioners must acknowledge in light of this Court's decisions in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 972 (1986), and more recently in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), slip op. 18-19, that "it might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy the power" (*Mississippi Power & Light Co.* v. *Mississippi*, slip op. 19). The court of appeals, on the other hand, does not question that the PUC's authority to disallow Equitable's costs on prudence grounds is limited by Equitable's obligation under the minimum bill provision to pay for a certain amount of Kentucky West's gas regardless of Equitable's actual purchases. Moreover, petitioners do not challenge the lower courts' determination that the PUC did not deny Equitable its right to recover minimum bill costs that it had actually incurred for gas not purchased from Kentucky West. The only matter truly in dispute before this Court is whether Equitable provided a sufficient "analytic framework" to support its claim that its decision to purchase gas from Kentucky West rather than from seemingly less expensive alternative sources was prudent because of the minimum bill costs Equitable *would have incurred* had it bought from those other sources (see Pet. 16-17; Pet. App. 21a).

a. The court of appeals held in part that petitioners failed to make an adequate evidentiary showing because they had not quantified their minimum bill obligation (Pet. App. 22a). In particular, the court explained, "[n]o mathematical figures were presented establishing what actual costs Equitable * * * would incur due to its minimum bill liability to Kentucky West, if it had purchased the gas from other suppliers in conformity with the PUC Order" (*ibid.*).

To the extent the court of appeals relied on Equitable's failure to quantify further its minimal bill obligation, we agree with petitioners that [reasoning] may be flawed. Because Equitable's purchases from Kentucky West during the relevant period were either at or below the minimum amount established by the minimum bill provision, those purchases were necessarily prudent *if the minimum bill provision was legally effective*; the cost to Equitable of purchasing that gas from other sources would have been the price charged by those other sources *plus* Equitable's minimum bill payments. Any other conclusion by the PUC would have ignored the import of the FERC-approved tariff, including the minimum bill provision, and hence violated the filed rate doctrine.[5]

b. In addition, however, the court of appeals also questioned the legal status of the minimum bill provision at the time that Equitable incurred the costs for which it sought recovery from the PUC. In this regard, the court of appeals concluded that the PUC

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[5] We therefore disagree with the PUC's intimation that the minimum bill obligation is not relevant to the prudence of Equitable's decision to purchase gas from Kentucky West, but rather only "increases a buyer's cost for quantities of gas *not taken*" (Br. in Opp. 6 n.4 (emphasis in original)).

was justified in refusing to consider Equitable's minimum bill liability because of the uncertain status of the minimum bill provision of the contract following Equitable's invocation of the *force majeure* clause (Pet. App. 21a). Petitioners' principal response (Pet. 15 nn. 12, 13) is that this conclusion of the court of appeals is mistaken because Equitable invoked *force majeure* only for the gas not needed and therefore did not intend to disturb its minimum obligation for gas it actually needed and did purchase.

The impact of Equitable's invocation of the *force majeure* clause on the minimum bill provision presents a question that is not well developed by the record. We have not duplicated the court of appeals' "time-consuming analysis of the proceedings below" (Pet. App. 21a) and at this stage of the case are not inclined to second guess the court of appeals' assessment of the record, particularly in light of the limited nature of FERC's participation in those proceedings (see note 4, *supra*). But, whatever the merits of the dispute about the significance of Equitable's invocation of the *force majeure* clause, we do not believe that this Court's review of the factbound issue is warranted.

In addition, although substantial sums of money are at stake in this case, the issue is unlikely to recur in the future. FERC has decided to eliminate minimum bill provisions from many pipelines tariffs, including Kentucky West's tariff, based on their anticompetitive effects. See, *e.g.*, FERC Order No. 380, 49 Fed. Reg. 22778 (1984), aff'd *sub nom. Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986); *Kentucky West Virginia Gas Co.*, 43 F.E.R.C. ¶ 61,496 (1988); *Texas Eastern Transmission Corp.*, 43 F.E.R.C. ¶ 61,076

(1988); see Pet. App. 69a-71a. Contrary to the claims of petitioners and their supporting amici, therefore, the court of appeals' ruling does not announce a rule of law of major practical import that risks creation of "considerable confusion regarding the application of previously-settled federal principles" (Pet. 19-20).

2. Like respondent PUC (Br. in Opp. 12-15), we also do not believe that further review is warranted on account of this Court's intervening decision in *Mississippi Power & Light Co.* v. *Mississippi*, *supra* (see Pet. 18-20). As petitioners acknowledge (Pet. 10), that decision simply "reaffirmed" the basic principle first set forth in *Nantahala* that a state may not treat as unreasonable or imprudent costs mandated by a FERC-approved contract (see *Mississippi Power & Light Co.* v. *Mississippi*, slip op. 18-19)). *Mississippi Power & Light* provides no particular guidance beyond that earlier provided in *Nantahala* on the question raised here, which is fairly confined to the significance of a utility's invocation of a *force majeure* clause on its minimum bill obligations. A remand for further consideration in light of this Court's decision in *Mississippi Power & Light* is therefore not required.

3. Finally, further review is not warranted because petitioners' concerns can be fully and more appropriately addressed in other proceedings. As described above, the court of appeals concluded that the PUC was justified in ignoring the minimum bill provision because of the uncertain legal status of that provision at the time Equitable incurred the costs for which it is now seeking recovery. Equitable and Kentucky West, however, have since entered into a settlement agreement (see Pet. App. 148a-149a) concern-

ing Equitable's minimum bill obligations. That agreement, which was approved by FERC shortly before petitioners filed their complaint in district court in this case, provides for reductions in Equitable's minimum bill obligation for the period July 1983 through July 1984. See *Kentucky West Virginia Gas Co.*, 33 F.E.R.C. ¶ 61,240 (1985). Hence, the extent of Equitable's minimum bill obligation during the relevant time period should no longer be uncertain and petitioners' request for recovery should be subject to reconsideration by the PUC.

Indeed, that is precisely what has happened. The PUC has since permitted Equitable to pass through in its retail rates the settlement amount that reflects the "fixed cost" component of the minimum bill obligation (approximately $2.5 million), which is part of the $14.3 million being sought in this litigation. See *PUC* v. *Equitable Gas Co.*, 87 P.U.R.4th 131, 136-139 (1987); PUC Br. in Opp. 4-5. In addition, although the PUC has more recently denied Equitable the right to recover an additional $10.2 million that Equitable claims reflects its minimum bill obligations under the settlement agreement for that period (see *PUC* v. *Equitable Gas Co.*, No. R-880932 (Sept. 1, 1988), slip op. 5-13; PUC Br. in Opp. 5 n.3), that development is not a reason for further review in this case. Instead, to the extent that the PUC's latest action may be inconsistent with the filed rate doctrine, because it fails to consider Equitable's minimum bill obligation in determining the prudence of its purchases, petitioners should challenge the PUC's adverse determination directly.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 1988

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* The Solicitor General is disqualified in this case.

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OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY AND EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC., PETITIONERS

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET AL., RESPONDENTS

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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REPLY BRIEF FOR THE PETITIONERS

A. The Filed Rate Doctrine.

We contended in the petition (at 12-20) that (1) the Pennsylvania PUC violated the filed rate doctrine by disallowing recovery in 1985 through retail rates of gas costs that Equitable was obligated to incur under the minimum bill provision of the Kentucky West tariff approved by FERC; (2) the court of appeals compounded the PUC's mistake by erroneously concluding that Equitable had failed to preserve its claim under the filed rate doctrine; and (3) the court of appeals' error is closely related to the error corrected by this Court in *Mississippi Power*, which was decided after the court of appeals rendered its decision here. We seek only the limited relief of a remand to the court of appeals for reconsideration in light of *Mississippi Power*.

Respondents' answering briefs confirm that something is seriously amiss in the decisions rendered by the tribunals below. Little attempt is made to meet our legal argument on the merits and to show how the PUC's order barring Equitable from recovering its costs comported with the filed rate doctrine. Respondents instead hide behind "factual" findings and waiver determinations made at earlier stages of the case. Especially significant are FERC's recognition (Br. 9) of the merit of Equitable's claim under the filed rate doctrine and its acknowledgment (*ibid.*) that the court of appeals utilized a fundamentally flawed legal standard in concluding that Equitable did not preserve its filed rate doctrine claim.

Eager to divert attention from the indefensible determinations made by the PUC and the courts below, respondents devote much of their briefs to arguing that the issue relating to the application of the filed rate doctrine is "narrow," "factbound," or "unimportant." But those considerations are dispositive only when the Court is asked to give plenary review to an issue. Here, petitioners simply seek a remand to the court of appeals so that it may reconsider in light of *Mississippi Power* the very determinations that the respondents are unwilling or unable to defend before this Court. In view of the fact that this case presents issues concerning the application of the filed rate doctrine that this Court addressed in *Mississippi Power*, that course of action is plainly appropriate.

1. *The Court of Appeals Erred by Concluding That Equitable Failed to Preserve its Filed Rate Doctrine Claim.*

The court of appeals stated that "[t]he absence of any quantification leads us to conclude that Equitable failed to advance this [filed rate doctrine] theory for recovery at trial" (Pet. App. 23a). The court rested that conclusion on two different—and somewhat inconsistent—grounds. Each is incorrect as a matter of law.

The court of appeals relied in part upon what it found to be Equitable's failure to adduce in the district court facts showing what its minimum bill liability would have been if it had not purchased the gas from Kentucky West and how that liability related to the cost of the gas that Equitable did purchase (Pet. App. 22a-23a). The state respondents contend that the court was correct in demanding such proof as the prerequisite for a claim under the filed rate doctrine. As we show in the petition (at 18), however, and as FERC agrees (Br. 9), it was error to require the production of evidence "quantif[ying]" Equitable's claim. In a case like this, a court need only compare the costs at issue with the provisions of the federal tariff in order to ascertain whether the filed rate doctrine mandates recovery of those costs. No more specific factual development is required.[1]

The court of appeals' approach is wrong for the additional reason that the "quantification" evidence identified by the court—evidence relating to charges for gas *not* taken—would not even have been relevant to Equitable's claim, for Equitable sought to pass through in 1985 only payments for gas that was taken. The court apparently adopted the erroneous notion, repeated by the state respondents (PUC Br. 6 n.4; OCA Br. 5-6 n.2), that a minimum bill provision is relevant only when a utility seeks to recover payments for gas *not* taken; on this view, payments of amounts at or below the amounts required by the minimum bill, if accompanied by deliveries of gas, do not qualify as "minimum bill payments." We explain in the petition (at 14-15) that, because the minimum bill mandates the payment of a fixed amount to the

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[1] Respondents thus err in asserting (PUC Br. 9-10; OCA Br. 8) that the petition seeks reexamination of the court of appeals' factual conclusions regarding the state of the record. The issue presented in this case is purely legal: we contend—and the FERC agrees—that the court of appeals committed a legal error by requiring a factual showing in the first place. In any event, the relevant facts and legal arguments were placed before the district court. See Pet. 18 n.17; Plaintiffs' Post-Trial Reply Br. at 7-8.

pipeline without regard to whether the utility takes delivery of the gas, all payments up to that amount are in satisfaction of the mandatory federally-imposed obligation and are entitled to the protection of the filed rate doctrine. FERC agrees (Br. 9 & n.5).[2]

The second part of the court of appeals' rationale was its decision to accord "preclusive effect" to the PUC's "factfinding" that the minimum bill obligation need not be considered in assessing the prudence of Equitable's gas purchases because "no minimum bill costs had ever actually been incurred" (Pet. App. 22a, 21a). This aspect of the decision suffers from a different, more significant, defect. The Court held in *Mississippi Power* that findings made in the course of a state-law prudence inquiry could not thwart the application of the filed rate doctrine. See 108 S. Ct. at 2440-2441. The court of appeals' approach, determining the applicability of the filed rate doctrine by according "preclusive effect" to the PUC's decision regarding the relevance of the federal tariff, is virtually identical to the standard condemned in *Mississippi Power* and therefore cannot stand in the face of that decision. See also Pet. 18-19.

FERC agrees that the court of appeals erred by imposing its "quantification" requirement upon Equitable, but it advances a wholly different ground—not relied on by the court of appeals—to justify the court of appeals' rejection of Equitable's filed rate doctrine claim. FERC suggests (Br. 9-10) that Equitable's declaration of *force*

[2] The absurdity of the PUC's position is readily shown. Suppose Equitable had simply disregarded the minimum bill completely and taken no gas from Kentucky West, meeting all its requirements by paying for deliveries from "less expensive" alternative sources. Equitable would then have been required by the minimum bill, even as ultimately modified by FERC, to pay Kentucky West millions of dollars, for which it would have received no gas. This payment to Kentucky West would have been conceded by the PUC to be a "minimum bill" payment. The fact that Equitable took delivery of the gas—for which it was obliged to pay in any event—and saved its ratepayers millions of dollars should not deprive it of the benefits of the filed rate doctrine.

majeure (see Pet. 6 n.6) might render the filed rate doctrine inapplicable to the costs at issue here.[3] This submission is quite odd: FERC does not claim that its new argument is actually correct, merely that because the theory *might* be right this Court need not grant relief with respect to the issues raised in the petition. But the speculative possibility that some other ground exists to withhold relief hardly justifies denying Equitable the opportunity to have its claims considered with the erroneous determinations cleared away. FERC or any other party would be free at that time to advance the *force majeure* theory on remand as a new ground for rejecting Equitable's claim.[4]

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[3] According to FERC (Br. 9-10) the court of appeals actually concluded that the *force majeure* declaration freed the PUC to disregard the minimum bill provision. But this novel interpretation of the court's opinion—not advanced by any of the other parties—is clearly wrong. The part of the opinion upon which FERC relies is a description of the rationale of the PUC's decision, not an independent assessment of the correctness of that decision. Indeed, the very next paragraph of the opinion sets forth the legal basis for according preclusive effect to the PUC's determinations. Pet. App. 21a-22a. The court would have had no need to establish that it could defer to the PUC's decision if it had just endorsed that decision on the merits.

[4] In fact, FERC's theory is clearly wrong. First, Equitable's unilateral declaration of *force majeure* could not and did not suspend the legal effect of FERC's approved tariff. See Pet. 15 n.13. Second, Equitable's declaration of *force majeure* was based on a dramatic decline in demand for its gas—it was the oversupply of gas, and not the price in Kentucky West's tariff, that alone afforded any colorable basis for invoking *force majeure* under Equitable's contracts with its pipeline suppliers. It would have been frivolous to declare *force majeure* insofar as Equitable was actually able to make economic use of any portion of the gas subject to the minimum bill requirement. *Restatement (Second) of Contracts* § 261 (1981) (impracticability defense available only when "a party's performance is made impracticable"). FERC distorts our argument when it asserts (Br. 10) that we contend that the *force majeure* declaration is irrelevant because Equitable "did not intend" to disturb its minimum bill obligation. Rather, the declaration is irrelevant because Equitable could not as a matter of law

2. *A Remand is Appropriate in This Case.*

It is the consistent practice of this Court to vacate and remand a lower court decision for reconsideration in light of an intervening decision of this Court when it finds the intervening decision "sufficiently analogous and, perhaps, decisive to compel re-examination of the case." *Henry* v. *City of Rock Hill*, 376 U.S. 776, 777 (1964); see also *Board of Trustees* v. *Sweeney*, 439 U.S. 24, 26 (1978) (Stevens, J., dissenting) (remand is appropriate when "the intervening decision has shed new light on the law which, if it had been available at the time of the court of appeals' decision, might have led to a different result"); *Mitchell* v. *United States*, 348 U.S. 905, 906 (1955) ("[w]e have not considered the merits of these cases, nor have we determined their relation to our recent opinions, supra, believing that re-examination by the Courts of Appeals is desirable even in those cases remotely involving the principles laid down in the [intervening] decisions"). That standard is clearly satisfied here.

As we have discussed (see page 4, *supra*), *Mississippi Power* clarified the law in a manner that lays bare the court of appeals' error. Respondents do not deny that the court of appeals' approach endorses the very sort of circumvention of the filed rate doctrine condemned in *Mississippi Power*. Indeed, a number of trade associations, representing all segments of the gas industry, have filed *amicus* briefs in this Court expressing their concern that the decision is likely to result in confusion in the lower courts and threatens to undermine the filed rate doctrine. American Gas Ass'n (AGA) Br. 9-11; United Distribution Companies (UDC) Br. 4; Interstate Natural Gas Ass'n of America (INGAA) Br. 10. That doctrine is one of the cornerstones of utility regulation, applicable to a wide range of federal tariff provisions

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obtain relief from the obligation where, as is the case with the purchases at issue here, it could at least to that extent render the performance required by the minimum bill provision.

other than minimum bills. AGA Br. 3-5; INGAA Br. 5-6.

Even if the relationship between *Mississippi Power* and the court of appeals' error were less clear, there are compelling reasons for a remand here. After all, a remand simply gives the court of appeals an opportunity to reconsider its ruling; Equitable will not prevail on the merits unless the court of appeals concludes that its claim is meritorious. In view of the substantial argument—endorsed by the FERC—that the court of appeals applied an erroneous legal standard in rejecting Equitable's claim, and in view of respondents' failure to provide a defense of the court of appeals' decision on the merits, further consideration of this case by the court of appeals is fully warranted.[5]

B. The Taking Claim.

The PUC's order barring Equitable from recovering its purchased gas costs rested upon the retroactive application of Act 74 to disallow expenses incurred prior to the effective date of that statute. See Pet. 20-24. Because the issue presented in the petition—whether such retroactive ratemaking violates the Takings Clause—is now before the Court in *Duquesne Light*, we suggested that, in the event the Court is not disposed to remand the case for reconsideration in light of *Mississippi Power*, it should be held for the decision in *Duquesne Light*.[6]

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[5] FERC suggests (Br. 11-12) that a remand is unnecessary because Equitable may be entitled to recover the amounts at issue in a rate case during a later year. But the PUC has turned away Equitable's final effort to recover the costs at issue. See *PUC* v. *Equitable Gas Co.*, No. R-880932 (Pa. PUC Sept. 1, 1988). While Equitable plans to seek judicial review of that determination, the PUC is likely to argue, as it stated in this opinion (see slip op. 12), that Equitable's claim is precluded by the rationale it adopted in the present case. This case should be kept alive in order to assure that Equitable does not end up being whipsawed out of a meritorious claim of substantial importance to its financial well-being.

[6] The court of appeals did not address retroactivity because it erroneously thought that Equitable could have avoided the Act 74

The state respondents contend (PUC Br. 16-18; OCA Br. 14-20) that the PUC did not engage in retroactive ratemaking because Act 74 did not embody a new standard but simply codified the prior rule governing the recovery of purchased gas costs. If that were all the statute was meant to do, there would have been little need to adopt a new formulation; the legislature could simply have relied on the prior "just and reasonable" standard. But Act 74 did more than that; it is one of a wave of new state laws imposing tighter standards for recovery of purchased gas costs. See Pet. 19; UDC Br. 6-9; AGA Br. 10 n.5. Indeed, the plain language of the Act 74 standard, which sets forth a complex test dependent upon a variety of considerations not identified in the prior statute (see Pet. App. 173a-175a), establishes beyond any doubt that the statute imposes a new, stricter test for gas purchase costs.

The legislative history of Act 74 confirms this conclusion. The law was adopted to "put pressure on our 43 gas utilities in this State to buy the least costly gas" in order to "arrest th[e] unnecessary increase in the cost of gas." Pennsylvania Legislative Journal-House 1971 (remarks of Rep. Kukovich), 1973 (remarks of Rep. Freeman) (1983); see also *ibid.* (requirement that companies buy the "cheapest possible gas" would "no doubt [result in] savings to the consumer"); *id.* at 1975

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standard by selecting another ratesetting procedure when it sought to recover the gas costs at issue here (see Pet. App. 35a). Neither of the state respondents defends the court's conclusion. The OCA argues (Br. 15-16 n.7) that Equitable could have foregone the gas purchase reimbursement process altogether by seeking a prospective increase in rates prior to July 1983. But Equitable would have had no reason to take that step, because Act 74 was not enacted until 1984. Thus, Equitable had no realistic alternative but to subject its claim to the Act 74 standard. See Pet. 23.

The PUC contends (Br. 18 n.7) that Equitable did not challenge the retroactive application of Act 74 in the courts below. But Equitable did raise a taking claim, and one element of that claim was the confiscatory effect of applying the restrictive Act 74 standard in evaluating the prudence of its gas purchases. See Pet. App. 33a-36a.

(remarks of Rep. Wambach) (adoption of Act 74 necessary because "[t]he PUC procedure does not allow for a thorough review of the utility's management and gas purchase decisions to insure that the utility company is trying to keep our costs as low as possible"). The legislature thus clearly intended to impose a more restrictive cost recovery standard.[7]

C. The Separate Counsel Requirement.

The requirement that Equitable retain separate counsel to represent ratepayers in FERC proceedings involving rate filings by Kentucky West unconstitutionally compels Equitable to advocate a particular viewpoint in those FERC proceedings regardless of whether it agrees or disagrees with that viewpoint. See Pet. 24-28. Respondents argue (PUC Br. 22-24; OCA Br. 22-24) that the order is justified because it cures the "inherent conflict" presented by Equitable's participation in Kentucky West rate proceedings (see OCA Br. 22). But there is no conflict—or, at least, there was none prior to the challenged order. Equitable and Kentucky West are sister companies owned by a single parent. It is up to that parent corporation—Equitable Resources, Inc.—to adjust the interests of its two subsidiaries in the manner that best serves its shareholders. Whenever Equitable's ratepayers have an interest in opposing Kentucky West before FERC, the PUC order almost by definition forces Equitable to speak against the interests of those shareholders.

Respondent cannot avoid the unacceptable consequences of the challenged order on the ground that it is content

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[7] The state respondents contend that the PUC's disapproval under Act 74 of the gas purchasing strategy that it had approved under the prior standard (see Pet. 20-21) does not show that a new, stricter standard is applied under Act 74: they assert that Equitable's declaration of *force majeure* changed the factual circumstances and therefore led to a different result. But the PUC did not even mention the declaration of *force majeure* in rejecting Equitable's cost recovery claim; it therefore seems unlikely that this fact was determinative of Equitable's claim.

neutral because it does not force Equitable to advocate a particular point of view. As the PUC acknowledges in virtually the same breath (Br. 24), "Equitable was directed to defend the interests of its own customers." While the order may not dictate the precise position that Equitable must take with respect to particular issues before the FERC, it does require Equitable to further a particular point of view—that of its ratepayers. As such, the order plainly is not content-neutral.

Finally, respondents make the startling claim (PUC Br. 28; OCA Br. 25) that Equitable has not been harmed by the order and that its constitutional objection accordingly is not ripe. For the past three years, Equitable has complied with the order, paying separate counsel to present arguments opposing its sister company's proposed tariffs. Both because it has suffered monetary harm and because it has endured the very compelled speech that the Constitution prohibits, Equitable clearly has been injured by the PUC's order. The PUC's indefensible imposition on Equitable's right to manage its legal affairs as it sees fit should be ended.

Respectfully submitted.

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No. 88-94

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IN THE

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Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*,
Respondents

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF ON BEHALF OF THE PENNSYLVANIA GAS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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BRIEF ON BEHALF OF THE PENNSYLVANIA GAS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF THE AMICUS CURIAE

Pursuant to Rule 42 of the Rules of this Court, the Pennsylvania Gas Association (hereinafter "PGA") submits this brief as *amicus curiae* in support of petitioners. Counsel for petitioners and counsel for the respondents, the Pennsylvania Public Utility Commission (hereinafter "PaPUC") and the Pennsylvania Office of Consumer

Advocate (hereinafter "PaOCA"), have consented to this filing.

The PGA is a statewide association whose membership includes the retailers and deliverers of over 90% of the natural gas that is consumed in Pennsylvania. With one exception those retailers and distributors of natural gas all are "public utilities," within the meaning of Section 102 of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 102 and, therefore, are regulated by the PaPUC. Among the purposes of the PGA are, first, to advance the art of managing the production, transmission, distribution and utilization of natural gas for public use and, second, to promote the mutual interest of its members by such other lawful and ethical means as are consistent with the functions of a non-profit business league. Traditionally, the PGA has carried out its purpose by, among other means, participating either as a party or as *amicus curiae* before state and federal regulatory agencies, and state and federal courts.

The local distribution company members of the PGA are served by seven interstate pipeline companies, all of which are "natural gas companies" within the meaning of the Natural Gas Act, 15 U.S.C. § 717 *et seq.* Those seven interstate pipeline companies are Columbia Gas Transmission Corporation, National Fuel Gas Supply Corporation, Texas Eastern Transmission Corporation, Tennessee Gas Pipeline Company, Transcontinental Gas Pipeline Corporation, CNG Transmission Corporation, and Kentucky-West Virginia Gas Company ("Kentucky-West Virginia"). With the exception of Kentucky-West Virginia, each of those interstate pipelines also is a member of the PGA. In 1987, the local distribution company members of the PGA purchased a total of 448,733 billion cubic feet of natural gas, of which over 80% either was purchased from or transported by the seven named interstate pipelines.

The PGA's member companies are affected substantially by the decision issued below by the Third Circuit Court of Appeals. The Circuit Court's decision, among other things, permits the PaPUC, during its ordinary review of the intrastate retail rates to be charged by gas utilities (including the member companies of the PGA), to engage in a "prudency review" of federally mandated costs incurred through purchases of natural gas by utilities from interstate pipeline suppliers. While the PGA in this case does *not* assert a challenge to the PaPUC's authority and power to engage in a prudency review of *avoidable costs* incurred by its member companies, the decision below also has the effect of permitting the PaPUC to deny the recovery of incurred costs which are *unavoidable*, and which previously have been determined to be reasonable by the Federal Energy Regulatory Commission ("FERC").

POSITION OF THE AMICUS CURIAE

The decision below represents a new, and, as contended by the PGA, unlawful state action contrary to existing precedent of this Court. When the decision below is applied to the PGA member companies by the PaPUC and the Pennsylvania courts, it can result in substantial "trapped costs" (that is, costs incurred and actually paid by the PGA member gas companies but not permitted by the PaPUC to be charged and collected from retail customers), contrary both to national law and existing precedent of this Court.

Specifically, it is the PGA's position that the decision of the Third Circuit Court of Appeals, below, represents an unlawful, unwarranted, and ill-advised departure from the "filed rate" doctrine established by this Court. That doctrine mandates state public utility commissions to permit utilities to recover, through retail rates, all fixed and unavoidable costs incurred pursuant to a contract with an interstate pipeline supplier, when those

fixed and unavoidable costs are embodied in rates reflected in a tariff approved by the FERC.

When the PGA member companies incur reasonable costs, such as purchased gas costs, and those costs are not permitted by the PaPUC to be charged to and collected from intrastate retail customers, the end result is a denial of the opportunity to earn a just and reasonable return upon the companies' investment. This denial of an opportunity to earn a fair return not only results in an immediate confiscation, it also has the significant effect of jeopardizing the ability to finance new construction or improvements (due to the low return offered to investors in the past), thereby jeopardizing the ability to earn a future return or to provide adequate service.

Accordingly, because the Circuit Court has decided a federal question in a way that conflicts with applicable decisions of this Court, the requested Petition for a Writ of Certiorari should be granted; thereafter, this Court should reverse the lower court's decision.

ARGUMENT

The Decision of the Court of Appeals Unwisely and Unlawfully Permits State Public Utility Commissions to Deny the Recorvery by Utilities of Fixed and Unavoidable Costs Incurred Pursuant to a Federally Approved Tariff

The law delineating and circumscribing the various state utility commissions' power to review a utility cost which has been reviewed previously by FERC is well established. Namely, this Court, in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), held that a state utility commission lacked the power under the provisions of the Supremacy Clause of the Constitution, to take *any action* that would have the effect of preventing a utility from recovering, through its intrastate retail rates, costs incurred by the utility pursuant to a FERC-approved tariff. This holding is but another decision in a long line of cases applying what has become

known as the "filed rate" doctrine, which provides that interstate rates filed with and approved by FERC *must* be given binding effect by state utility commissions in setting intrastate rates. *See also Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981); *Federal Power Commission v. Southern California Edison Co.*, 376 U.S. 205 (1964); *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951). Most recently, this Court in *Mississippi Power & Light Company v. Mississippi*, —— U.S. ——, 56 L.W. 4751 (1988), found that the Supreme Court of Mississippi lacked the power under the Supremacy Clause to require the state public service commission to examine the prudency of a state utility's investment, where that prudency question, although not decided expressly by FERC, was under FERC's jurisdiction. It is the PGA's position that the PaPUC's failure in the instant case, in setting intrastate rates, to consider and to account for a cost of service incurred pursuant to a FERC-approved tariff, violated the provisions of the filed rate doctrine and the Supremacy Clause of the Constitution.

Simply stated, while PaPUC may have the power to determine that a jurisdictional gas utility should have acquired a portion of its gas supply either from its own production, or from a source of supply different than the source which was chosen by the utility, in calculating any ratemaking disallowance based upon prudency considerations, the PaPUC (or any state public service commission) must account for any unavoidable cost (such as a minimum bill liability) which that utility was obligated to pay to the supplier actually chosen. In the instant case, in making its intrastate ratemaking disallowance based upon prudency considerations, the PaPUC unlawfully ignored Equitable's unavoidable minimum bill liability owed to Kentucky-West Virginia, which liability was incurred pursuant to a just and reasonable and FERC-approved tariff. This simple *failure to consider and to account for* the minimum bill liability is contrary to the filed rate

doctrine and the Supremacy Clause, and should have been enjoined by the Federal courts below.

Furthermore, any specific quantification of the amount of the liability should not, and it is submitted, cannot be found to be fatal to Kentucky-West Virginia's and Equitable's claim, because the PaPUC's simple failure to recognize and account for the amount of the liability ignores Federal law. That is, regardless of the ultimate merits of Kentucky-West Virginia's and Equitable's claim (and the PGA supports the merits as advocated by the Petitioners in this proceeding), it is the position of the PGA that the PaPUC's simple refusal to recognize and account for the federally approved liability is, by itself, a violation of the Supremacy Clause.

Equitable specifically raised the issue before the PaPUC that its production acquisitions from its own sources resulted in lower net costs, considering its minimum commodity bill liability to Kentucky-West Virginia (*see* App. 140a). Yet, a review of the PaPUC's Opinion and Order (*see* App., R132a-145a) reveals substantially no response by the PaPUC to Equitable's position, and significantly, no recognition by the PaPUC of the existence of that liability in a calculation of the dollar amount which was disallowed for intrastate rate recovery.[1] For example, with regard to the PaPUC's first ratemaking disallowance of a purchase of 1,369,339 Mcf from Kentucky-West Virginia, in the dollar amount of $5,958,829 (or approximately a $4.43 per Mcf disallowance), it is clear that this

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[1] The only cursory reference to the issue of the effect of the minimum bill liability (on the proposed ratemaking adjustment) contained in the Commission's Opinion and Order, involves a notation by the PaPUC that the PaOCA had *argued* that Equitable did not demonstrate that the shutting-in of local production was cost justified in relation to the minimum commodity bill which it would have incurred (*see* App., R140a). This notation of an PaOCA argument, however, cannot be considered a finding; and, clearly it is not a specific accounting for the minimum bill liability.

entire disallowance represents, in the PaPUC's own words, a "*displacement*" of Kentucky-West Virginia, purchases; it also is clear that this entire disallowance is the average price of Kentucky-West Virginia gas (*see* App., 142a; or $4.19 to $4.92 per Mcf). That is, the PaPUC simply rejected Equitable's choice of purchase and recalculated its purchased gas costs without the purchase from Kentucky-West Virginia, ignoring the fact that Equitable had a minimum bill liability to Kentucky-West Virginia if it did not purchase the volumes taken. A review of the remainder of the PaPUC's Opinion and Order reveals no determination or finding by the PaPUC that Equitable had exceeded its total volume minimum bill liability, a finding which it is submitted is a prerequisite to making the $4.43 disallowance per Mcf for the volumes in question. Similarly, there is no finding in the PaPUC's Opinion and Order that Equitable had exceeded its minimum bill liability for the other two ratemaking dollar "adjustments" for the period of time of June, 1983, to December, 1984; these adjustments too represented a simple displacement of volumes and a recalculation of purchased gas costs.

CONCLUSION

The PaPUC in this case has disregarded the existence of Equitable's minimum bill liability, which liability is a just and reasonable expense and was incurred in accordance with a FERC approved tariff. The PGA recognizes that if Equitable indeed had exceeded its total volume minimum bill liability, then the PaPUC had the legal power to make an intrastate ratemaking adjustment, if the facts also warranted such a "prudency" adjustment; however, a specific finding by the PaPUC that Equitable had exceeded its total volume minimum bill liability is a legal prerequisite, under the filed rate doctrine, to such a ratemaking adjustment. Because this prerequisite finding was not made, the filed rate doctrine was violated, and the PaPUC's action should have been enjoined.

Just as FERC-mandated allocations of power are binding on the states, which must treat those allocations as fair and reasonable when determining intrastate retail rates, *Nantahala*, so are FERC-approved minimum bill liabilities binding upon the states. The PaPUC's action which ignores the minimum bill liability should have been enjoined, and the lower courts' failure to do so is contrary to precedent of this Court; accordingly, a Writ of Certiorari should be issued and argument on the merits should be heard.

Respectfully submitted,

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

This *amicus curiae* brief is respectfully submitted pursuant to Rules 21 and 36 of this Court by the Interstate Natural Gas Association of America ("INGAA") in support of the Petition for Writ of Certiorari of Kentucky West Virginia Gas Company and Equitable Gas Company, a Division of Equitable Resources, Inc.[1]

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[1] In accordance with Supreme Court Rule 36, INGAA has obtained the consent of all parties currently participating in this proceeding to file this brief as *amicus curiae*. These letters of consent have been filed with the Clerk of the Court.

INTEREST OF THE AMICUS CURIAE

INGAA is a nonprofit national association whose members include virtually all of the major interstate natural gas transmission companies operating in the United States and three Canadian interprovincial pipelines which are categorized as Group I pipelines by the National Energy Board of Canada.[2] Its U.S. members account for over 90% of all natural gas transported and sold for resale in interstate commerce, and they are subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717 *et seq.*; the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 *et seq.* These companies provide interstate wholesale natural gas service[3] in the lower 48 contiguous states with the exception of Vermont. The average number of states served by these pipelines is six, but some companies serve as many as eighteen states.

The decision of the Third Circuit in *Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (1988) involves the proper interpretation of the filed rate doctrine as defined by this Court on numerous occasions and most recently in *Mississippi Power & Light Co. v. Mississippi*, 108 S.Ct. 2428 (1988) ("*Mississippi Power*"), and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) ("*Nanta-*

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[2] *See* Appendix, *infra*. The natural gas industry is divided into three basic segments. Broadly speaking, gas producers operate the wells that are the source of natural gas; interstate natural gas pipelines buy and transport gas from the wellhead to points of delivery; and local distribution companies are the utilities that provide service to homes and businesses, as well as large industrial end users.

[3] The term "natural gas company" is defined in the NGA as "a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." 15 U.S.C. § 717a(6) (1982). The term "wholesale" when used in this brief, is synonymous with the phrase "sale . . . for resale" in § 717a(6).

hala"). The Third Circuit misconstrued the doctrine in a manner that threatens to adversely impact the interstate natural gas pipeline industry and is inconsistent with this Court's rulings in *Mississippi Power* and *Nantahala*.

SUMMARY OF ARGUMENT

The Pennsylvania Public Utility Commission ("PUC") denied the right of petitioner Equitable Gas Company ("Equitable") to recover costs incurred by it in purchasing natural gas at wholesale under a federally approved tariff from petitioner Kentucky West Virginia Gas Company ("Kentucky West"). Relying on a new state law, Pennsylvania Act 74, 66 Pa. Cons. Stat. Ann. 1307(f) *et seq.*[4], the state agency disallowed the passthrough of certain purchased gas costs because the purchaser ("Equitable"), notwithstanding its contractual obligation to pay for minimum amounts of gas from the interstate supplier ("Kentucky West"), had not, in the view of the PUC, demonstrated that it had prudently pursued a least-cost fuel procurement policy in accordance with Pennsylvania Act 74. The sale and purchase of the gas in question were covered by tariffs filed with and approved by the FERC. Thus, the question presented is whether the filed rate doctrine established by this Court in *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951) and reaffirmed in *Mississippi Power* and *Nantahala*, requires a state public utility commission to allow a utility to recover through its retail rates a fixed, unavoidable cost incurred by the utility pursuant to its contract with a pipeline embodied in a tariff approved by the FERC.

In passing the NGA in 1938, the Congress declared that "the business of transporting and selling natural gas for ultimate distribution to the public is affected with a pub-

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[4] The relevant portions of Pa. Act 74 are printed in the Appendix to the Petition, Appendix H, at 168a-75a.

lic interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest." 15 U.S.C. 717(a). Even before enactment of the NGA, this Court stated categorically that the sale of gas in wholesale quantities across state lines was a matter for national, rather than local, regulation. *See Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298, 309-310 (1924). The Court went on to say, "The paramount interest is not local but national, admitting of and requiring uniformity of regulation." *Id.* Thus it has long been settled that interstate sales of natural gas for resale are not subject to state regulation. Moreover, the Court has repeatedly held that the NGA provides "a comprehensive scheme of federal regulation of 'all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company.'" *Northern Natural Gas Co. v. State Corporation Comm'n*, 372 U.S. 84, 91 (1963) (quoting *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 682 (1954)); *see also Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409, 418-24 (1986); *Schneidewind v. ANR Pipeline Co.*, 108 S.Ct. 1145 (1988).

The filed rate doctrine is an essential component of the comprehensive scheme of federal regulation. The Commission's authority to regulate interstate wholesales of natural gas is exclusive. *Cf. Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981). The part of the doctrine that applies here holds that a "state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." *Nantahala*, 476 U.S. at 965; *see also Mississippi Power*, 108 S.Ct. at 2440. When the FERC approved the minimum bill provision in Kentucky West's tariff, Equitable became subject to an unavoidable federal obligation and entitled to recover

same through its retail rates. Thus, the Pennsylvania PUC's refusal to allow Equitable to recover such costs violates the filed rate doctrine. Further, it contravenes the comprehensive scheme of Federal regulation mandated by Congress and recognized by this Court, and is inconsistent with this Court's pronouncements that "a state agency's 'efforts to regulate commerce must fall when they conflict with or interfere with federal authority over the same activity.'" *Id.* at 2442 (quoting with approval *Chicago & North Western Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 318-19 (1981)).

Because the Third Circuit's ruling is strikingly similar to the error recently corrected by this Court in *Mississippi Power*, petitioner's request should be granted and a writ of certiorari issued to the Third Circuit's decision.

ARGUMENT

I. THE COURT OF APPEALS' DECISION CREATES CONFUSION ABOUT THE CONTOURS OF THE FILED RATE DOCTRINE AND THREATENS TO ADVERSELY IMPACT THE INTERSTATE NATURAL GAS PIPELINE INDUSTRY.

A. Pipelines Recover A Significant Proportion Of Their Fixed Costs Through Fixed Charges Set By The FERC.

The natural gas pipeline industry is highly capital intensive, with huge investments in pipeline and appurtenant facilities such as compressor stations and metering and pressure regulating equipment. This is reflected in the net utility plant of major interstate natural gas pipelines for 1986 of $9,227,398,000.[5] These plant costs incurred by a pipeline are allocated among a pipeline's customers by the FERC pursuant to FERC's exclusive NGA authority to set the wholesale rates charged by interstate

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[5] EIA Statistics of Interstate Natural Gas Pipeline Companies, 1986, Table 1 at 5.

pipelines. *See* 15 U.S.C. §§ 717c-717d. The Commission uses several methodologies to allocate costs among pipeline customers. For example, the Commission has authorized pipelines to include in their rates a "demand charge"—a fixed sum paid by a customer regardless of the amount of gas the customer actually purchases from the pipeline—that is designed to permit the pipeline to recover a portion of its fixed costs—its investment in facilities. In addition to making large investments in facilities, each pipeline must ensure that it has sufficient supply to fulfill its obligation to deliver to the customer the amount of gas to which that customer is contractually entitled. The supply contracts traditionally entered into by pipelines with producers in order to satisfy this obligation frequently contain "take-or-pay" clauses requiring the pipeline to pay for a minimum amount of gas whether or not it actually takes delivery of that gas. Such payments also are part of a pipeline's cost. *See generally Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1150-51 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986).[6]

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[6] Similarly, most pipelines, until recently, were permitted to have minimum bill provisions in their tariffs which imposed upon certain of the pipeline's customers the unavoidable obligation to pay for a specified amount of gas whether or not the customer took delivery of that gas. The purpose of such a provision was to provide pipelines with a source of revenue to cover a portion of their fixed costs and their take-or-pay obligations to gas producers. In its Order No. 380, issued May 30, 1984, *FERC Statutes and Regulations* [*Regulations Preambles 1982-1985*], ¶ 30,571 (1984), *aff'd, Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986), the FERC eliminated variable cost but not the fixed cost recovery portion of the minimum bill. (This action, however, essentially post-dates the period of cost recovery at issue before the PUC, July, 1983-December, 1984). Furthermore, the Pennsylvania PUC's implementation of Act 74, as will be shown *infra*, goes well beyond the elimination of variable cost recovery through minimum bills. It would deny the pipeline's customers the opportunity, indeed the right, to recover *fixed costs*

In the instant case, the costs incurred by Kentucky West in supplying its customers, including Equitable, were allocated among those customers in accordance with Kentucky West's filed tariff and the methodology employed and approved by the FERC. By reason of that action, Equitable was obligated to take delivery of, or pay for if not taken, minimum quantities of natural gas from Kentucky West. The PUC, in denying Equitable its right to recover the costs of its purchases from Kentucky West on the ground that they were not prudently incurred costs and inconsistent with Pennsylvania Act 74, has launched a direct attack on well-established preemptive force of Federal Energy Regulatory Commission approved tariffs and the recovery of those FERC-approved costs when they are passed on to the interstate pipeline's utility customers.[7] This ruling, which was affirmed by the Third Circuit, is inconsistent with the recent decision of this Court in *Mississippi Power*, that the Supremacy Clause bars a state from applying a state-law prudency standard to prevent a utility from recovering costs that the utility was obligated to incur under a FERC-approved tariff.

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of the pipeline as approved by the FERC and included in the pipeline's filed rates. This is at the very core of the federal regulatory scheme and represents a direct and substantive incursion on that scheme.

[7] The filed rate doctrine which the filed tariff represents was established by this Court in *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951) and stands for the proposition that the rate filed and approved by the Federal Power Commission, predecessor to the FERC, is the only legitimate rate. The preemptiveness of wholesale rates on file or approved by the FERC was recognized by this Court in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981). The relevant provisions of Pa. Act 74 are printed in the Appendix to the Petition, Appendix H at 168a-75a.

B. The Court Of Appeals' Decision Is Clearly At Odds With The Filed Rate Doctrine.

The filed rate doctrine protects the "exclusive authority" of the FERC to "determine the reasonableness of wholesale rates." *Mississippi Power*, 108 S.Ct. at 2439; *Nantahala*, 476 U.S. at 963-64. This Court held in *Mississippi Power* that

> . . . States may not bar regulated utilities from passing through to retail customers FERC-mandated wholesale rates. "The filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the cost of paying the FERC-approved rate. . . . Such a 'trapping' of costs is prohibited."

Id. (quoting *Nantahala*, 476 U.S. at 970).

The application of this principle is clearest when a utility incurs a fixed, unavoidable cost pursuant to a FERC-approved tariff, such as a fixed cost imposed upon local distribution companies ("LDCs") by the demand charge or minimum bill provisions of pipelines' tariffs. Since LDCs are legally obligated to incur these FERC-approved costs, state utility commissions must permit their recovery through the LDC's retail rates. *Mississippi Power* at 2440; *Nantahala*, 476 U.S. at 965.

The petition for writ of certiorari shows (at 12-20) that the PUC violated the filed rate doctrine when it barred Equitable from recovering through its retail rates costs incurred pursuant to the minimum bill provision of Kentucky West's FERC-approved tariff. The court of appeals' failure to correct that error itself creates uncer-

tainty about the application of the filed rate doctrine in this context. The Third Circuit concluded (Pet. App. at 21a, 837 F.2d at 610) that a minimum bill provision was not relevant because Equitable sought to recover costs incurred for gas that was delivered rather than costs for gas that was not delivered. But the applicability of the minimum bill provision does not turn upon whether Equitable chose to take delivery of the gas; that provision imposed upon Equitable the fixed unavoidable obligation of paying a specified amount of money to Kentucky West whether it took the gas or not. The obligation of an LDC to pay an allocated share of its pipeline supplier's fixed costs is ongoing and not solely dependent upon the minimum bill.

The Third Circuit's opinion goes on to compound the uncertainty by apparently concluding that state regulators are free to determine whether a FERC-approved tariff need ever be considered in setting retail rates. Under the court's erroneous analysis, the relevance of the FERC tariff under the filed rate doctrine is a question of fact, as to which the state regulatory commission's determination is "preclusive," even though that determination was made in the course of a state-law prudency proceeding. Pet. App. at 21a-22a, 837 F.2d at 611.

The Third Circuit's approach is plainly wrong. Allowing the states to use factual findings of the sort cited by the court of appeals (Pet. App. at 20a-21a, 837 F.2d at 610) to avoid the effect of the filed rate doctrine gives the states a clear opportunity to prevent the passthrough of FERC-approved costs whenever they wish. Such latitude would be a clear infringement by the states on the comprehensive scheme of federal regulation which this Court has so often sought to protect. See *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409 (1986), *Schneidewind v. ANR Pipeline Co.*, 108 S.Ct. 1145 (1988).

C. In Order To Eliminate Uncertainty And Avoid Adverse Consequences For The Pipeline Industry, This Court Should Grant The Relief Sought By Petitioners.

As indicated above, the uncertainty generated by the court of appeals' opinion about the extent to which the filed rate doctrine requires state regulators to allow the recovery of fixed costs approved by the FERC could have serious adverse consequences for the natural gas industry in general and for pipelines in particular. If a local distribution company cannot recover expenditures in satisfaction of FERC-approved fixed charges, the financial stability of the industry will clearly be threatened. Pipelines and distributors are entitled to the opportunity to recover their prudently incurred costs. Those investments were undertaken on the basis of FERC certificates of public convenience and necessity and on the basis of approved tariffs. Likewise, distributors are entitled to recover these prudently incurred costs in their retail rates. The Third Circuit's ruling destroys that symmetry and involves the very "trapping" of costs which was condemned by this Court in *Mississippi Power*.

At the retail level, the Third Circuit's decision casts doubt upon an LDC's right to insist that a particular cost be passed through to its retail customers pursuant to the filed rate doctrine. To the extent other courts and state regulatory bodies adopt a similar approach, the resulting confusion could turn the natural gas industry upside down. In view of the considerable fixed costs borne by pipelines (see page 5, *supra*), such a state of affairs could seriously affect the economic viability of interstate natural gas pipelines, and cast doubt on their ability to render whatever service may indeed be requested of them.[8]

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[8] This result would also unsettle the expectations of pipeline investors, who previously could be certain that LDCs would be able to pass these FERC-approved fixed charges through to consumers pursuant to the filed rate doctrine.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted to the U.S. Court of Appeals of the Third Circuit.

Respectfully submitted,

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September 19, 1988

APPENDIX

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

1988 ACTIVE MEMBERSHIP

AlaTenn Resources, Inc.
Arkla, Inc.
The Coastal Corporation
Columbia Gas Transmission Corp.
Consolidated Natural Gas Company
El Paso Natural Gas Company
Enron Corp.
Foothills Pipe Lines (Yukon) Ltd.
Granite State Gas Transmission, Inc.
Great Lakes Gas Transmission Company
Kentucky West Virginia Gas Company
KN Energy, Inc.
Lone Star Gas Company
Michigan Gas Storage Company
MidCon Corp.
Pacific Gas Transmission Company
Pacific Interstate Company
Panhandle Eastern Corporation
Polo Energy Corporation
Questar Pipeline Company
SONAT, Inc.
Tenneco Gas Pipeline Group
Texas Eastern Gas Pipeline Company
Texas Gas Transmission Corporation
Texas Oil & Gas Corporation
TransCanada Pipe Lines
Transcontinental Gas Pipe Line Corporation
United Gas Pipe Line Company
Valero Interstate Transmission Company
Valley Gas Transmission, Inc.
Westcoast Energy Inc.
The Williams Companies
Williston Basin Interstate Pipeline Company
Wintershall Corporation

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

1988 ASSOCIATE MEMBERS

AMAX Oil & Gas Inc.
Amoco Production Company
ARCO Oil and Gas Company
Atlanta Gas Light Company
The Brooklyn Union Gas Company
Chevron USA
Conoco Inc.
Entex, Incorporated
Exxon Company, U.S.A.
John H. Hill
Kerr-McGee Corporation
Kinsey Interests, Inc.
Laclede Gas Company
Lear Petroleum Exploration Company
Marathon Oil Company
Mewbourne Oil Company
Mobil Oil Corporation
National Fuel Gas Company
Northern Indiana Public Service Company
Oklahoma Natural Gas Company,
a Division of ONEOK Inc.
OXY USA Inc.
Pennzoil Company
Phillips Petroleum Company
Shell Oil Company
Southern California Gas Company
Sun Exploration & Production Company
Texaco U.S.A.
Union Pacific Resources Company
Unocal Corporation

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No. 88-94

IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY AND EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC.,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*,
Respondents

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF OF AMERICAN GAS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF OF AMERICAN GAS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The American Gas Association ("A.G.A."), pursuant to Rule 36 of this Court, submits this brief *amicus curiae* in support of the petition for a *writ of certiorari* filed by the Kentucky West Virginia Gas Company ("Kentucky West") and Equitable Gas Company, a division of Equitable Resources, Inc. ("Equitable"), to vacate the judgment of the Court of Appeals for the Third Circuit and remand the case for reconsideration or, in the alternative,

grant plenary review of the court of appeals judgment. A.G.A. has received the consent of all parties to file this brief as *amicus curiae*.

The A.G.A. is a nonprofit trade association representing the interests of approximately 250 member companies involved in the distribution and transmission of natural gas throughout the 50 states and the District of Columbia. A.G.A. member companies account for approximately 85% of this nation's annual gas utility sales. Approximately 32 A.G.A. distribution companies are regulated by more than one state utility commission. Petitioners are members of the A.G.A. and Equitable is regulated by three state commissions and by the Federal Energy Regulatory Commission ("FERC").

INTEREST OF THE AMICUS CURIAE

The question presented in this case regarding the scope of the filed rate doctrine is of particular interest to the members of the A.G.A. that are local distribution companies ("LDCs"). LDCs purchase natural gas from pipelines and other sources at rates and quantities regulated by FERC under the Natural Gas Act of 1938, 15 U.S.C. §§ 717-717z (1982 & Supp. III 1985) ("NGA"), and the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1982 & Supp. III 1985) ("NGPA"), and distribute and resell that gas to retail customers at rates regulated by state public utility commissions. This dual federal-state oversight could subject an LDC to inconsistent regulation, with FERC directing the LDC to pay a particular cost at the wholesale level and a state commission barring the LDC from recovering that same cost through its retail rates. The filed rate doctrine is designed to prevent such "trapping" of costs by requiring state commissions to allow LDCs to recover through their retail rates all FERC-mandated wholesale costs. The doctrine thus plays a crucial role in defining the proper relationship between federal and state regulation of the natural gas industry.

In the last few years, first in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and more recently in *Mississippi Power & Light Co.* v. *Mississippi*, 108 S.Ct. 2428 (1988), this Court has clarified the contours of the filed rate doctrine as it applies in this context. The decision of the court of appeals, which predated *Mississippi Power*, is clearly inconsistent with the principles spelled out by the Court in that decision. Moreover, the court of appeals' decision is likely to spawn new confusion about the scope of the doctrine by implying that determinations made by state regulators under state law may in some circumstances prevent an LDC from invoking the filed rate doctrine to protect its right to recover FERC-mandated costs. The A.G.A. accordingly submits this *amicus curiae* brief urging the Court to grant the petition, vacate the decision below and remand the case for reconsideration in light of this Court's subsequent decision in *Mississippi Power*. Alternatively, the Court should grant the petition and set the case for oral argument.

ARGUMENT

The Court Of Appeals' Mistaken Interpretation Of The Filed Rate Doctrine Should Be Corrected Because It Is Likely To Create Confusion Among State Regulators And Render Uncertain The Right Of Local Distribution Companies To Recover FERC-Mandated Costs Through Their Retail Rates.

A. *The Filed Rate Doctrine Prevents Conflicts Between State And Federal Regulation Of The Natural Gas Industry And Helps Ensure The Financial Integrity Of Local Distribution Companies.*

The aspect of the filed rate doctrine that is relevant in this case holds that "States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates." *Mississippi Power & Light Co.* v. *Mississippi*, 108 S.Ct. 2428, 2439 (1988). If a tariff or contract on file with FERC requires a utility

to pay an unavoidable cost as part of the wholesale rate for a commodity (*see Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 581-82 (1981)), or requires a utility to purchase a fixed quantity of a commodity (*Mississippi Power; Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986)), the state commission must permit the utility to recover through its retail rates any costs incurred pursuant to that FERC-approved tariff.[1]

This principle, which is grounded in the Supremacy Clause, is a necessary consequence of Congress's decision to endow the Federal Energy Regulatory Commission with exclusive authority to regulate wholesale natural gas rates. *See* 15 U.S.C. § 717c (1982). If the filed rate doctrine did not require state utility commissions to accept FERC's determination that a particular charge imposed upon an LDC as part of a wholesale rate is just and reasonable, and allowed the States to conclude instead that payment of the charge was imprudent or unreasonable, a state commission could bar the LDC from recovering the cost through its retail rates. That would undermine FERC's exclusive authority over wholesale rates and render the comprehensive federal scheme of regulation, under both the NGA and NGPA, for the sale of natural gas in interstate commerce, a nullity. This is the precise purpose for invoking pre-emption.

The filed rate doctrine also furthers principles of fairness, protecting LDCs from the financial injury that would result if they could be caught in the middle of regulatory disputes between FERC and the state commission. Uncertainty about the filed rate will jeopardize the financial decisions of the LDCs as well as the posture

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[1] The filed rate doctrine imposes other limitations with respect to FERC-approved rates. For example, regulated sellers of natural gas may not collect a rate other than the rate on file with FERC, and the Commission and the courts may not retroactively alter the rate charged for gas already sold. *See Arkansas-Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577-79 (1981); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951)

of the LDCs in the financial community. An LDC is assured that it can act on the basis of FERC's findings that a particular cost is reasonable without fear that state regulators might later reach a different conclusion and prevent the utility from recovering the cost from its ratepayers.

B. *The Decision Below Misapplies The Filed Rate Doctrine In A Manner That Is Clearly Inconsistent With The Principles Announced By This Court In* Mississippi Power.

1. The court of appeals failed to consider the significance of the minimum bill provision in this case, even though it recognized that petitioner Equitable had entered into a FERC-approved long-term gas supply contract with petitioner Kentucky West that included a minimum bill provision "requir[ing] Equitable to purchase from Kentucky West a minimum amount of gas in exchange for which Kentucky West guarantee[d] that that amount will be available for Equitable's consumption." Pet. App. at 19a n.7. At the time of the events at issue in this case, minimum bill provisions like the one contained in the Kentucky West contract required LDCs such as Equitable to pay for a specified quantity of gas *whether or not the LDC actually took delivery of the corresponding volume of gas.* The minimum bill provision imposed upon Equitable an unavoidable obligation to pay a fixed sum to Kentucky West.[2]

Contrary to the apparent view of the Pennsylvania Public Utility Commission ("Pennsylvania PUC") and

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[2] Minimum bill provisions were commonplace in the natural gas industry; they guaranteed gas purchasers (such as LDCs) sources of long term supply and guaranteed gas suppliers (such as pipelines) a long term return on their investment. The purpose of such provisions was to allocate risk associated with changes in the levels of supply and demand, protecting purchasers in the event of demand increases or supply shortages and protecting suppliers in the event of demand reductions or oversupply.

the court of appeals, the payments to Kentucky West at issue in this case do constitute payments pursuant to Equitable's obligation under the minimum bill. True, Equitable paid only that part of its minimum bill obligation that corresponded to its actual need for delivered gas and sought to invoke *force majeure* to avoid the balance of its obligation; but it did not ask the Pennsylvania PUC to allow recovery of the unliquidated portion of the minimum bill obligation. Equitable had no unilateral power to cancel its FERC-approved contract with Kentucky West, and to the extent its payments to Kentucky West were below the sum it was federally obligated to pay, they are properly treated as being in partial satisfaction of that federal obligation and therefore subject to the filed rate doctrine.[3]

The filed rate doctrine plainly requires state regulators to permit the recovery in retail rates of payments made pursuant to FERC-approved minimum bills. Indeed, this Court's decision in *Mississippi Power* is dispositive on this point. The Court there held that the filed rate doctrine prevented the State form disallowing costs incurred pursuant to a FERC order allocating a specified amount of high-cost electric power to a utility. The Court stated:

> [I]t might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power. But if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for [the utility] to procure the particular quantity of high-priced . . . power that FERC has ordered it to pay for.

108 S.Ct. at 2440. As in *Mississippi Power*, Equitable did not have the legal right to refuse to make the purchases of high-priced gas which the Pennsylvania PUC

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[3] This is confirmed by the evident fact that Kentucky West would have had to take Equitable's payments for delivered gas into account in determining its remaining liability under the minimum bill provision.

found imprudent. Therefore, as in *Mississippi Power*, the Pennsylvania PUC lacked the power to bar Equitable from recovering the cost of those FERC-mandated expenditures through its retail rates.[4]

Indeed, putting the filed-rate doctrine to one side for the moment, it is clear that the Pennsylvania PUC should have permitted Equitable to recover its actually incurred minimum bill costs for the entirely separate reason that the purchasing strategy pursued by Equitable was entirely prudent under the circumstances. An LDC facing declining levels of demand while at the same time bound by a minimum bill obligation can best protect its ratepayers by taking the volume of gas specified in the minimum bill provision—for which the LDC must pay in any event—and reducing its purchases from sources of gas not subject to minimum bill provisions, such as independent producers or LDC-owned production. If the LDC took gas from those other sources, as the Pennsylvania

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[4] In both *Mississippi Power* and *Nantahala*, this Court reserved the question whether " 'a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*.' " *Mississippi Power*, 108 S.Ct. at 2440 (citation omitted; emphasis in original); *Nantahala*, 476 U.S. at 972 (citing *Pike County Light & Power Co.* v. *Pennsylvania Public Utility Comm'n*, 77 Pa. Commw. 268, 273-74, 465 A.2d 735, 737-38 (1983)). That issue is not presented in this case for the simple reason that it arises only when the costs disallowed by the state commission are optional, not mandatory. *See Mississippi Power*, 108 S.Ct. at 2440; *Nantahala*, 476 U.S. at 972. Thus, the utility in *Pike County* was free to choose whether to procure high-cost power or low-cost power. Here, by contrast, Equitable had *no choice* under its FERC-approved contract but to pay for gas from Kentucky West; the Pennsylvania PUC wrongly presumed that Equitable could choose not to pay Kentucky West and simply purchase gas elsewhere. *See* Pet. App. at 123a, 140a-42a. Because the minimum bill provision obligated Equitable to purchase a specified quantity of gas from Kentucky West, the Pennsylvania PUC's determination that Equitable made an imprudent "choice" violated the filed rate doctrine.

PUC said it should have done, it would have had to pay for that gas *and* make its minimum bill payments as well, a course of action guaranteed to result in higher total gas costs.

2. The court of appeals' erroneous reading of the filed rate doctrine resulted from the "preclusive effect" (Pet. App. at 20a) that the court accorded to the Pennsylvania PUC's "refusal to consider minimum bill liability in evaluating whether Equitable had pursued a least cost fuel procurement policy. . . ." Pet. App. at 21a. But the question before the court of appeals—whether the cost that Equitable sought to recover in its retail rates were protected by the filed rate doctrine because they had been incurred pursuant to a FERC-approved unavoidable obligation—is not a question of fact, but rather a question of law that the court itself should have answered by examining the provisions of Kentucky West's FERC tariff.

The court of appeals' refusal even to consider the relevance of the minimum bill to petitioners' claim under the filed rate doctrine effectively leaves to state regulators the decision whether a particular expense is related to a FERC-approved obligation. One of the basic purposes of the filed rate doctrine is to limit the authority of the States by requiring them to adhere to FERC's reasonableness determinations. If state regulators could preclude a claim under the filed rate doctrine by simply failing to discuss relevant provisions of FERC-approved tariffs in the course of a state-law prudence inquiry, a gaping hole would be opened in the protection afforded by the doctrine, allowing state regulators to override the filed rate doctrine essentially whenever they wish.

The court of appeals' approach is not only wrong as a matter of general principles, it is squarely contrary to this Court's decision in *Mississippi Power*. The Court in that case rejected the argument that findings made in the course of a state-law prudence determination could override the requirements of the filed rate doctrine (*see*

108 S.Ct. at 2440-41). The same result must obtain here: analysis under the filed rate doctrine cannot be short-circuited by factual findings made in a state-law prudence review. The question whether the predicate for application of the filed rate doctrine has been satisfied is a legal issue that must be determined in accordance with federal law.

C. *This Court Should Grant The Petition And Remand The Case For Reconsideration In Order To Avoid Confusion Over The Contours Of The Filed Rate Doctrine.*

Congress's adoption of the NGPA together with subsequent administrative initiatives by the Federal Energy Regulatory Commission, have worked a "comprehensive[] and dramatic[]" change in federal regulation of the natural gas industry. *Public Service Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 322 (1983). By eliminating price controls on most wellhead sales of natural gas, the NGPA "give[s] market forces a more significant role in determining the supply, the demand, and the price of natural gas. . . ." *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, 474 U.S. 409, 422 (1986). The Commission's administrative actions have similarly increased the role of market forces in the wholesale gas market, principally by making it easier for buyers of gas in that market—such as local distribution companies—to shift their business from one supplier to another on the basis of price and other competitive considerations. *See, e.g.*, Order No. 436, 50 Fed. Reg. 42408 (1985), FERC Statutes and Regulations [Regulations Preambles 1982-1985] ¶ 30,665 (1985), *aff'd in part and rev'd in part sub nom. Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 108 S.Ct. 1468 (1988); Order No. 380, 49 Fed. Reg. 22778 (1984), FERC Statutes and Regulations [Regulations Preambles 1982-1985] ¶ 30,571 (1984), *aff'd in part and rev'd in part sub nom. Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986).

This enhanced competition among sellers of gas at the wholesale level has not gone unnoticed by the States. In order to encourage LDCs to take advantage of the new competition in the wholesale market to lower their gas supply costs, an increasing number of States are requiring local distribution companies to pursue a least-cost strategy in purchasing gas supplies. The LDC must show that it purchased gas at the lowest available price in order to recover the cost of gas purchases in their retail rates. Failure to make such a showing may result in the denial of the utility's request for the recovery of gas purchase costs.[5]

As more States subject LDC gas procurement decisions to intensive scrutiny, it is important that the relationship between such state-law inquiries and the filed rate doctrine be clear. The decision below is likely to leave courts uncertain about how to apply the filed rate doctrine in this context. In addition, state regulators might believe that they are free to decide for themselves the extent to which they are required to take account of a FERC tariff in a state-law prudence inquiry. Indeed, the lower court's decision in *Mississippi Power* shows the potential for confusion in this area: despite this Court's then-recent *Nantahala* decision, the lower court in *Mississippi Power*

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[5] Nine States have adopted statutes requiring gas purchasing prudence review. *See, e.g.*, Cal. Pub. Util. Code §§ 785, 785.5 (enacted 1983 and 1985), respectively); Ill. Rev. Stat. ch. 111 2/3, §§ 8-401, 8-402 (effective 1986); Iowa Code Ann. § 476.6(15) (enacted 1984); Md. Code Ann. art. 78 § 54D; Mich. Comp. Laws Ann. § 460.6h; N.Y. Pub. Serv. Law ch. 519, §§ 66-e, 66-f (amended 1984); Ohio Admin. Code §§ 4901:1-14-07, 1-14-08; W.Va. Code §§ 24-2-4c, 24-2-16; Wyo. Stat. § 15-1-103(a)(xxxiii)(C), (b), (c) (effective 1985) and Wyo. Stat. § 37-3-201 through 205 (enacted 1987). Other state regulatory commissions review the prudence of LDC procurement decisions pursuant to their general authority to require just and reasonable rates or to supervise utility energy planning. *See, e.g., Re Nevada Power Co.*, 74 P.U.R. 4th 703 (Nev. P.S.C., May 30, 1986); Wash. Admin. Code § 480-90-191 (promulgated 1987).

completely misconstrued the filed rate doctrine when presented with a case arising in the context of a state-law prudence determination.

Because *Mississippi Power*, which was decided after the court of appeals' decision in the present case, holds that state-law prudence findings are not determinative of the inquiry under the filed rate doctrine, the Court should direct the court of appeals to reconsider its decision in light of *Mississippi Power*. Indeed, failure to direct the court of appeals to reconsider its decision in light of *Mississippi Power* might give state regulators, as well as other courts, the mistaken impression that the decision below is a proper application of the filed rate doctrine. That would cause still more confusion regarding the scope of the doctrine. Since the relief sought by petitioners is limited, and the possibility of damage to the filed rate doctrine is considerable, the Court should grant the petition and remand the case for reconsideration in light of *Mississippi Power*.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted, the judgment of the Court of Appeals for the Third Circuit vacated, and the case remanded for reconsideration in light of *Mississippi Power & Light Co.* v. *Mississippi*, 108 S.Ct. 2428 (1988). In the alternative, the Court should grant plenary review of the judgment of the court of appeals.

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In The Supreme Court of the United States

OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY
AND
EQUITABLE GAS COMPANY, a division of
EQUITABLE RESOURCES, INC.
Petitioners,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
et al.
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR UNITED DISTRIBUTION COMPANIES AS AMICI CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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---

BRIEF FOR UNITED DISTRIBUTION COMPANIES AS AMICI CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Interest of Amici Curiae.[1]

United Distribution Companies ("UDC") is an *ad hoc* group of organizations that provide gas utility service to the general public. UDC was formed in 1969 and is comprised of 32 organizations that render in the aggregate more than 20% of all gas utility service throughout

[1]Each of the parties to this appeal has consented to the filing of this *amicus curiae* brief. These consents have been filed with the Court.

the United States.[2] The members of UDC render service in the states of Illinois, Indiana, Michigan, Missouri, New Jersey, New York, Ohio, Pennsylvania, West Virginia and Wisconsin. Petitioner Equitable Gas Company is a member of UDC.

The members of UDC operate in whole or in part as local distribution companies ("LDCs"). LDCs are public utilities that sell natural gas at retail to local consumers. State or local utility commissions regulate these

[2]The members of United Distribution Companies are:

Battle Creek Gas Company
Central Illinois Light Company
Central Illinois Public Service Company
Citizens Gas & Coke Utility
Citizens Gas Fuel Company
Consumers Power Company
The Dayton Power and Light Company
The East Ohio Gas Company
Equitable Gas Company
Hope Gas, Inc.
Illinois Power Company
Indiana Gas Company
Kokomo Gas and Fuel Company
Michigan Gas Company
Michigan Gas Utilities Company
National Fuel Gas Distribution Corporation
Niagara Mohawk Power Corporation
North Shore Gas Company
Ohio Gas Company
Orange & Rockland Utilities, Inc.
The Peoples Gas Light and Coke Company
The Peoples Natural Gas Company
Richmond Gas Corporation
The River Gas Company
Rochester Gas and Electric Corporation
Southeastern Michigan Gas Company
Union Electric Company
West Ohio Gas Company
Wisconsin Fuel and Light Company
Wisconsin Gas Company
Wisconsin Natural Gas Company
Wisconsin Southern Gas Company

retail sales. Each company is under a statutory duty within its respective state to provide service to any customer in its service area, and to obtain supplies of natural gas that are adequate to serve consumer demands. To carry out these statutory duties, each LDC must be afforded the opportunity to charge rates that recover all expenses that were reasonably incurred pursuant to the regulatory regime in existence at the time the expenditures were made.

At the same time, UDC members acquire much of their natural gas supplies through wholesale purchases from interstate pipelines. The Federal Energy Regulatory Commission ("FERC") regulates these interstate wholesale sales transactions pursuant to the Natural Gas Act, 15 U.S.C. § 717 *et seq.* In light of the federal regulation of interstate wholesale sales of natural gas and the state or local regulation of retail sales, UDC members are particularly susceptible to being "trapped," *Mississippi Power and Light Co. v. Mississippi*, 108 S.Ct. 2428, 2439 (1988) by state or local regulatory policies and procedures that prevent LDCs from recovering the cost of paying federally-approved rates for gas purchased in a wholesale sales transaction. As *Amici* demonstrate below, the likelihood of such "trapping" of costs has increased dramatically as more states pursue least cost gas procurement policies. *Amici*, therefore, have a direct and substantial interest in this case.

Reasons for Granting the Writ.

This case presents an important opportunity for this Court to clarify how two federal principles apply to the implementation of state policies and procedures for regulating LDCs.

One principle is the doctrine of federal preemption. Although this Court has recently reaffirmed that "states may not bar regulated utilities from passing through to retail customers FERC-mandated wholesale rates," *Mississippi Power*, 108 S.Ct. at 2439, the decision of the Court of Appeals below has permitted Pennsylvania to implement a statute establishing a least cost gas purchasing policy for LDCs[3] in a manner that has "trapped" petitioner Equitable by denying recovery of expenses Equitable was obligated to incur pursuant to the minimum bill requirements in the federally-approved tariff of one of Equitable's interstate pipeline gas suppliers. The Court of Appeals' decision thus stands in the way of a clear understanding and application of this Court's decisions in *Mississippi Power* and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986).

The other principle that requires clarification is one of federal takings law. The decision of the Court of Appeals has permitted Pennsylvania to confiscate Equitable's investment by changing retroactively the applicable ratemaking rules after Equitable had already incurred significant expenses to secure gas supplies in furtherance of its statutory duty to serve. This unconstitutional regulatory treatment parallels Pennsylvania's result-oriented treatment of electric utility cancellation costs in *Duquesne Light Co. v. Barasch*, No. 87-1160, *prob. juris. noted*, 108 S.Ct. 1105 (1988). In *Duquesne*, Pennsylvania applied a new statute barring recovery of investment in cancelled electric generating plants after the utilities had incurred such investment and after the plants in question

[3]Pennsylvania Act 1984-74, 66 Pa.C.S. § 1307(f), 1317-18 (hereinafter "Act 74").

had been found to be prudently cancelled. By applying its least cost purchasing policy retroactively to Equitable's gas purchases made before Act 74 was enacted, Pennsylvania in this case has once again manipulated a seemingly straightforward new ratemaking method in an effort to minimize the resulting rates paid by its consumers.

The Court's intervention is necessary to enlighten state regulators concerning how these important principles of federal law apply to an area of state regulation that is expanding rapidly across the nation. *Amici*, therefore, join in petitioners' request that the petition for writ of certiorari be granted, the judgment of the Court of Appeals vacated, and the case remanded for reconsideration in light of *Mississippi Power*, or, in the alternative, that the petition be granted for consideration of the takings issue or held for disposition as appropriate in light of the decision on this issue in *Duquesne*.

1. The market pressures that resulted in Pennsylvania's adoption of a least cost gas procurement policy are nationwide in scope. The partial deregulation of wellhead natural gas prices caused by the enactment of Natural Gas Policy Act, 15 U.S.C. §§ 3301 *et seq.*, and the reduction in demand for natural gas caused by declining oil prices and other factors, produced a sharp swing in the natural gas market. The United States Court of Appeals for the District of Columbia Circuit observed that "the net result of these converging factors was to convert the gas supply shortage of 1977 to 1978 to the gas supply surplus of 1982 to 1985." *Wisconsin Gas. Co. v. FERC*, 770 F.2d 1144, 1151 (1985), *cert. denied* 476 U.S. 1114 (1986).

This change in market conditions has spurred regulators interested in minimizing retail natural gas rates to develop regulatory policies and procedures designed to encourage LDCs to abandon long-term supply arrangements in favor of short-term purchases in the lower-cost spot market. Natural gas supply planning necessarily involves tradeoffs between long-term reliability and short-term costs. State regulation may allocate between these competing concerns as long as the LDCs are afforded notice of what conduct the state will require of it, *cf. Mullane v. Central Hanover Trust Co.*, 339 U.S. 306 (1950), and the state's action is consistent with applicable federal regulatory requirements.

2. When the wholesale market for natural gas was characterized by shortages, LDCs were under pressure to enter into long-term supply contracts in order to secure a stable supply of natural gas to meet their statutory duty to serve.[4] By the time when the market changed and abundant supplies of natural gas became available, many LDCs had already prudently entered into contracts containing specific purchase requirement provisions, such as the minimum bill provisions in

[4]Indeed, federal regulations place interstate pipelines under pressure to secure long-term contracts from their LDC customers. *See e.g.*, 18 C.F.R. § 157.14(a)(11)(v). Section 157.14(a)(11)(v) requires pipelines seeking a certificate of public convenience to include in their application:

> Conformed copy of each contract, letter of intent or other agreement for sale or transportation of natural gas proposed by the application. Indicate the rate to be charged. If no agreements have been made, indicate the basis for assuming that contracts will be consummated and that service will be rendered under the terms contemplated in the application.

Id. FERC will dismiss an application for a certificate of public convenience where the pipeline is unable to "show that a committed market exists for its sales." *In re National Fuel Gas Corp.*, 32 F.E.R.C. (CCH) ¶ 61,226 at 61,522 (1985).

Equitable's contracts, that had become embodied in FERC-approved tariffs. The unforeseen and rapid change in the level of natural gas supplies available for sale, however, put strong public pressure on states to develop policies that would take advantage of the gas supply surplus and would lead to lower retail natural gas rates in rapid fashion.

The shift in regulatory emphasis toward short-term cost minimization is understandable. Nonetheless, any shift in state regulation of LDC purchasing practices must be consistent with federal policies and regulations that govern wholesale sales of natural gas. When states move too hastily in pursuing policies aimed at cost minimization, they can easily intrude upon federal policies and regulatory requirements. For example, as evidenced by the case at the bar, a change in state regulatory policy on LDC purchasing practices can impose new duties on LDCs that conflict with the LDCs' existing purchase obligations under the wholesale sales tariffs that are regulated and approved by FERC. States cannot be permitted to implement least cost policies in ways that entrap LDCs and deny them the right to recover costs assessed by their pipeline suppliers under FERC-approved tariffs.

Similarly, state regulators risk conflicting with the federal constitution when they move too hastily to implement a change in policy without prior notice to the utility. As evidenced by the case at bar, when a state implements a change in policy after an LDC has secured long-term supply contracts with minimum bill provisions that are embodied in a FERC-approved tariff, that change may confiscate the LDC's investment by preventing it from recovering an unavoidable cost of

doing business. Under such circumstances, the retroactive implementation of new state ratemaking requirements interferes with the constitutional rights of the LDC's investors.

3. Pennsylvania is not alone in recently implementing a least cost purchasing policy in response to the radical changes in the natural gas market. More than a dozen states within the last five years have enacted statutes or adopted regulations directing utilities to pursue least cost purchasing strategies, and have implemented regulatory procedures for the review of LDC gas purchasing decisions. *See* Smoots, *Report on State Least-Cost Gas Purchasing Requirements*, 2 NAT. GAS LAW. J. 110 (1987). As a result,

> [e]xplicit limitations on the gas purchasing practices of distributors are both increasingly common and of increasing importance to the gas industry. Although most states have traditionally reviewed distributor gas purchasing as part of the rate consideration process, never before has this oversight been as intensive, systematic and broad-based.

Id. at 110.

Moreover, the regulatory concept of least cost utility planning is a methodology that is becoming increasingly prevalent in all areas of regulation. The recent decline in oil prices, and the escalation in the cost of nuclear plant capacity prices have induced many regulators to adopt least-cost planning programs in the electric utility area as well. A survey conducted by the Arizona Corporation Commission found that 16 states had implemented some form of least cost planning programs with respect to their electric utilities, 9 states were in the process of developing such programs, and

5 states were considering the development of such programs. *See* Berry, *Least-Cost Planning and Utility Regulation,* PUB. UTIL. FORT., Mar. 17, 1988 at 9. The regulatory procedures at issue in this case, therefore, have significance in many areas of utility regulation.

4. The decision in this case will send a signal to state regulators concerning the manner in which such changes in regulatory policy should be implemented in order to be consistent with federal law. Given the proliferation of state regulatory approaches that embody the concept of least cost purchasing, the frequency of regulatory action such as that undertaken in the case at bar is likely to increase dramatically.

The case at bar stands in sharp contrast to cases in other jurisdictions where least cost purchasing policies have been applied only in a prospective manner. *See e.g., In re Columbia Gas of West Virginia, Inc.,* 47 PUR4th 392 (1982). In *Columbia Gas,* the West Virginia Public Service Commission expressly declined to apply its least cost purchasing policy retroactively and declined to adjust the utility's rates because "the new standards of care established in this order are standards of which Columbia has not had notice prior to issuance of this order." *Id.* at 440.

If the decision of the Court of Appeals in the present case is permitted to stand, jurisdictions adopting new regulatory approaches would be free to ignore the considered approach taken in West Virginia. Instead, states would be encouraged to implement new approaches in a way that blindsides the utilities and saddles them with costs that are part of a FERC-approved tariff and, as such, are not avoidable. The decision be-

low should be vacated in order to inform state regulators that changes in policy must be implemented in a manner designed to avoid interfering with federally-approved rates and the constitutional rights of public utility investors.

CONCLUSION

The petition for a writ of certiorari should be granted, the judgment of the court of appeals vacated, and the case remanded for reconsideration in light of *Mississippi Power & Light Co. v. Mississippi*, 108 S. Ct. 2428 (1988). In the alternative, the Court should grant the petition or hold it for disposition as appropriate in light of the decision in *Duquesne Light Co. v. Barasch*, No. 87-1160 *prob. juris. noted*, 108 S.Ct. 1105 (1988).

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On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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BRIEF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

This *amicus curiae* brief is respectfully submitted pursuant to Rules 21 and 36 of this Court by the Interstate Natural Gas Association of America ("INGAA") in support of the Petition for Writ of Certiorari of Kentucky West Virginia Gas Company and Equitable Gas Company, a Division of Equitable Resources, Inc.[1]

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[1] In accordance with Supreme Court Rule 36, INGAA has obtained the consent of all parties currently participating in this proceeding to file this brief as *amicus curiae*. These letters of consent have been filed with the Clerk of the Court.

INTEREST OF THE AMICUS CURIAE

INGAA is a nonprofit national association whose members include virtually all of the major interstate natural gas transmission companies operating in the United States and three Canadian interprovincial pipelines which are categorized as Group I pipelines by the National Energy Board of Canada.[2] Its U.S. members account for over 90% of all natural gas transported and sold for resale in interstate commerce, and they are subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717 *et seq.*; the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 *et seq.* These companies provide interstate wholesale natural gas service[3] in the lower 48 contiguous states with the exception of Vermont. The average number of states served by these pipelines is six, but some companies serve as many as eighteen states.

The decision of the Third Circuit in *Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (1988) involves the proper interpretation of the filed rate doctrine as defined by this Court on numerous occasions and most recently in *Mississippi Power & Light Co. v. Mississippi*, 108 S.Ct. 2428 (1988) ("*Mississippi Power*"), and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) ("*Nanta-*

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[2] *See* Appendix, *infra*. The natural gas industry is divided into three basic segments. Broadly speaking, gas producers operate the wells that are the source of natural gas; interstate natural gas pipelines buy and transport gas from the wellhead to points of delivery; and local distribution companies are the utilities that provide service to homes and businesses, as well as large industrial end users.

[3] The term "natural gas company" is defined in the NGA as "a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." 15 U.S.C. § 717a(6) (1982). The term "wholesale" when used in this brief, is synonymous with the phrase "sale . . . for resale" in § 717a(6).

hala"). The Third Circuit misconstrued the doctrine in a manner that threatens to adversely impact the interstate natural gas pipeline industry and is inconsistent with this Court's rulings in *Mississippi Power* and *Nantahala*.

SUMMARY OF ARGUMENT

The Pennsylvania Public Utility Commission ("PUC") denied the right of petitioner Equitable Gas Company ("Equitable") to recover costs incurred by it in purchasing natural gas at wholesale under a federally approved tariff from petitioner Kentucky West Virginia Gas Company ("Kentucky West"). Relying on a new state law, Pennsylvania Act 74, 66 Pa. Cons. Stat. Ann. 1307(f) *et seq.*[1], the state agency disallowed the passthrough of certain purchased gas costs because the purchaser ("Equitable"), notwithstanding its contractual obligation to pay for minimum amounts of gas from the interstate supplier ("Kentucky West"), had not, in the view of the PUC, demonstrated that it had prudently pursued a least-cost fuel procurement policy in accordance with Pennsylvania Act 74. The sale and purchase of the gas in question were covered by tariffs filed with and approved by the FERC. Thus, the question presented is whether the filed rate doctrine established by this Court in *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951) and reaffirmed in *Mississippi Power* and *Nantahala*, requires a state public utility commission to allow a utility to recover through its retail rates a fixed, unavoidable cost incurred by the utility pursuant to its contract with a pipeline embodied in a tariff approved by the FERC.

In passing the NGA in 1938, the Congress declared that "the business of transporting and selling natural gas for ultimate distribution to the public is affected with a pub-

[1] The relevant portions of Pa. Act 74 are printed in the Appendix to the Petition, Appendix H, at 168a-75a.

lic interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest." 15 U.S.C. 717(a). Even before enactment of the NGA, this Court stated categorically that the sale of gas in wholesale quantities across state lines was a matter for national, rather than local, regulation. *See Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298, 309-310 (1924). The Court went on to say, "The paramount interest is not local but national, admitting of and requiring uniformity of regulation." *Id.* Thus it has long been settled that interstate sales of natural gas for resale are not subject to state regulation. Moreover, the Court has repeatedly held that the NGA provides "a comprehensive scheme of federal regulation of 'all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company.'" *Northern Natural Gas Co. v. State Corporation Comm'n*, 372 U.S. 84, 91 (1963) (quoting *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 682 (1954)); *see also Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409, 418-24 (1986); *Schneidewind v. ANR Pipeline Co.*, 108 S.Ct. 1145 (1988).

The filed rate doctrine is an essential component of the comprehensive scheme of federal regulation. The Commission's authority to regulate interstate wholesales of natural gas is exclusive. *Cf. Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981). The part of the doctrine that applies here holds that a "state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." *Nantahala*, 476 U.S. at 965; *see also Mississippi Power*, 108 S.Ct. at 2440. When the FERC approved the minimum bill provision in Kentucky West's tariff, Equitable became subject to an unavoidable federal obligation and entitled to recover

same through its retail rates. Thus, the Pennsylvania PUC's refusal to allow Equitable to recover such costs violates the filed rate doctrine. Further, it contravenes the comprehensive scheme of Federal regulation mandated by Congress and recognized by this Court, and is inconsistent with this Court's pronouncements that "a state agency's 'efforts to regulate commerce must fall when they conflict with or interfere with federal authority over the same activity.'" *Id.* at 2442 (quoting with approval *Chicago & North Western Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 318-19 (1981)).

Because the Third Circuit's ruling is strikingly similar to the error recently corrected by this Court in *Mississippi Power*, petitioner's request should be granted and a writ of certiorari issued to the Third Circuit's decision.

ARGUMENT

I. THE COURT OF APPEALS' DECISION CREATES CONFUSION ABOUT THE CONTOURS OF THE FILED RATE DOCTRINE AND THREATENS TO ADVERSELY IMPACT THE INTERSTATE NATURAL GAS PIPELINE INDUSTRY.

A. Pipelines Recover A Significant Proportion Of Their Fixed Costs Through Fixed Charges Set By The FERC.

The natural gas pipeline industry is highly capital intensive, with huge investments in pipeline and appurtenant facilities such as compressor stations and metering and pressure regulating equipment. This is reflected in the net utility plant of major interstate natural gas pipelines for 1986 of $9,227,398,000.[5] These plant costs incurred by a pipeline are allocated among a pipeline's customers by the FERC pursuant to FERC's exclusive NGA authority to set the wholesale rates charged by interstate

[5] EIA Statistics of Interstate Natural Gas Pipeline Companies, 1986, Table 1 at 5

pipelines. *See* 15 U.S.C. §§ 717c-717d. The Commission uses several methodologies to allocate costs among pipeline customers. For example, the Commission has authorized pipelines to include in their rates a "demand charge"—a fixed sum paid by a customer regardless of the amount of gas the customer actually purchases from the pipeline—that is designed to permit the pipeline to recover a portion of its fixed costs—its investment in facilities. In addition to making large investments in facilities, each pipeline must ensure that it has sufficient supply to fulfill its obligation to deliver to the customer the amount of gas to which that customer is contractually entitled. The supply contracts traditionally entered into by pipelines with producers in order to satisfy this obligation frequently contain "take-or-pay" clauses requiring the pipeline to pay for a minimum amount of gas whether or not it actually takes delivery of that gas. Such payments also are part of a pipeline's cost. *See generally Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1150-51 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986).[6]

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[6] Similarly, most pipelines, until recently, were permitted to have minimum bill provisions in their tariffs which imposed upon certain of the pipeline's customers the unavoidable obligation to pay for a specified amount of gas whether or not the customer took delivery of that gas. The purpose of such a provision was to provide pipelines with a source of revenue to cover a portion of their fixed costs and their take-or-pay obligations to gas producers. In its Order No. 380, issued May 30, 1984, *FERC Statutes and Regulations* [*Regulations Preambles 1982-1985*], ¶ 30,571 (1984), *aff'd*, *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986), the FERC eliminated variable cost but not the fixed cost recovery portion of the minimum bill. (This action, however, essentially post-dates the period of cost recovery at issue before the PUC, July, 1983-December, 1984). Furthermore, the Pennsylvania PUC's implementation of Act 74, as will be shown *infra*, goes well beyond the elimination of variable cost recovery through minimum bills. It would deny the pipeline's customers the opportunity, indeed the right, to recover *fixed costs*

In the instant case, the costs incurred by Kentucky West in supplying its customers, including Equitable, were allocated among those customers in accordance with Kentucky West's filed tariff and the methodology employed and approved by the FERC. By reason of that action, Equitable was obligated to take delivery of, or pay for if not taken, minimum quantities of natural gas from Kentucky West. The PUC, in denying Equitable its right to recover the costs of its purchases from Kentucky West on the ground that they were not prudently incurred costs and inconsistent with Pennsylvania Act 74, has launched a direct attack on well-established preemptive force of Federal Energy Regulatory Commission approved tariffs and the recovery of those FERC-approved costs when they are passed on to the interstate pipeline's utility customers.[7] This ruling, which was affirmed by the Third Circuit, is inconsistent with the recent decision of this Court in *Mississippi Power*, that the Supremacy Clause bars a state from applying a state-law prudency standard to prevent a utility from recovering costs that the utility was obligated to incur under a FERC-approved tariff.

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of the pipeline as approved by the FERC and included in the pipeline's filed rates. This is at the very core of the federal regulatory scheme and represents a direct and substantive incursion on that scheme.

[7] The filed rate doctrine which the filed tariff represents was established by this Court in *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951) and stands for the proposition that the rate filed and approved by the Federal Power Commission, predecessor to the FERC, is the only legitimate rate. The preemptiveness of wholesale rates on file or approved by the FERC was recognized by this Court in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981). The relevant provisions of Pa. Act 74 are printed in the Appendix to the Petition, Appendix H at 168a-75a.

B. The Court Of Appeals' Decision Is Clearly At Odds With The Filed Rate Doctrine.

The filed rate doctrine protects the "exclusive authority" of the FERC to "determine the reasonableness of wholesale rates." *Mississippi Power*, 108 S.Ct. at 2439; *Nantahala*, 476 U.S. at 963-64. This Court held in *Mississippi Power* that

> . . . States may not bar regulated utilities from passing through to retail customers FERC-mandated wholesale rates. "The filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the cost of paying the FERC-approved rate. . . . Such a 'trapping' of costs is prohibited."

Id. (quoting *Nantahala*, 476 U.S. at 970).

The application of this principle is clearest when a utility incurs a fixed, unavoidable cost pursuant to a FERC-approved tariff, such as a fixed cost imposed upon local distribution companies ("LDCs") by the demand charge or minimum bill provisions of pipelines' tariffs. Since LDCs are legally obligated to incur these FERC-approved costs, state utility commissions must permit their recovery through the LDC's retail rates. *Mississippi Power* at 2440; *Nantahala*, 476 U.S. at 965.

The petition for writ of certiorari shows (at 12-20) that the PUC violated the filed rate doctrine when it barred Equitable from recovering through its retail rates costs incurred pursuant to the minimum bill provision of Kentucky West's FERC-approved tariff. The court of appeals' failure to correct that error itself creates uncer-

tainty about the application of the filed rate doctrine in this context. The Third Circuit concluded (Pet. App. at 21a, 837 F.2d at 610) that a minimum bill provision was not relevant because Equitable sought to recover costs incurred for gas that was delivered rather than costs for gas that was not delivered. But the applicability of the minimum bill provision does not turn upon whether Equitable chose to take delivery of the gas; that provision imposed upon Equitable the fixed unavoidable obligation of paying a specified amount of money to Kentucky West whether it took the gas or not. The obligation of an LDC to pay an allocated share of its pipeline supplier's fixed costs is ongoing and not solely dependent upon the minimum bill.

The Third Circuit's opinion goes on to compound the uncertainty by apparently concluding that state regulators are free to determine whether a FERC-approved tariff need ever be considered in setting retail rates. Under the court's erroneous analysis, the relevance of the FERC tariff under the filed rate doctrine is a question of fact, as to which the state regulatory commission's determination is "preclusive," even though that determination was made in the course of a state-law prudency proceeding. Pet. App. at 21a-22a, 837 F.2d at 611.

The Third Circuit's approach is plainly wrong. Allowing the states to use factual findings of the sort cited by the court of appeals (Pet. App. at 20a-21a, 837 F.2d at 610) to avoid the effect of the filed rate doctrine gives the states a clear opportunity to prevent the passthrough of FERC-approved costs whenever they wish. Such latitude would be a clear infringement by the states on the comprehensive scheme of federal regulation which this Court has so often sought to protect. See *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board*, 474 U.S. 409 (1986), *Schneidewind v. ANR Pipeline Co.*, 108 S.Ct. 1145 (1988).

C. In Order To Eliminate Uncertainty And Avoid Adverse Consequences For The Pipeline Industry, This Court Should Grant The Relief Sought By Petitioners.

As indicated above, the uncertainty generated by the court of appeals' opinion about the extent to which the filed rate doctrine requires state regulators to allow the recovery of fixed costs approved by the FERC could have serious adverse consequences for the natural gas industry in general and for pipelines in particular. If a local distribution company cannot recover expenditures in satisfaction of FERC-approved fixed charges, the financial stability of the industry will clearly be threatened. Pipelines and distributors are entitled to the opportunity to recover their prudently incurred costs. Those investments were undertaken on the basis of FERC certificates of public convenience and necessity and on the basis of approved tariffs. Likewise, distributors are entitled to recover these prudently incurred costs in their retail rates. The Third Circuit's ruling destroys that symmetry and involves the very "trapping" of costs which was condemned by this Court in *Mississippi Power*.

At the retail level, the Third Circuit's decision casts doubt upon an LDC's right to insist that a particular cost be passed through to its retail customers pursuant to the filed rate doctrine. To the extent other courts and state regulatory bodies adopt a similar approach, the resulting confusion could turn the natural gas industry upside down. In view of the considerable fixed costs borne by pipelines (see page 5, *supra*), such a state of affairs could seriously affect the economic viability of interstate natural gas pipelines, and cast doubt on their ability to render whatever service may indeed be requested of them.[8]

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[8] This result would also unsettle the expectations of pipeline investors, who previously could be certain that LDCs would be able to pass these FERC-approved fixed charges through to consumers pursuant to the filed rate doctrine.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted to the U.S. Court of Appeals of the Third Circuit.

Respectfully submitted,

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APPENDIX

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

1988 ACTIVE MEMBERSHIP

AlaTenn Resources, Inc.
Arkla, Inc.
The Coastal Corporation
Columbia Gas Transmission Corp.
Consolidated Natural Gas Company
El Paso Natural Gas Company
Enron Corp.
Foothills Pipe Lines (Yukon) Ltd.
Granite State Gas Transmission, Inc.
Great Lakes Gas Transmission Company
Kentucky West Virginia Gas Company
KN Energy, Inc.
Lone Star Gas Company
Michigan Gas Storage Company
MidCon Corp.
Pacific Gas Transmission Company
Pacific Interstate Company
Panhandle Eastern Corporation
Polo Energy Corporation
Questar Pipeline Company
SONAT, Inc.
Tenneco Gas Pipeline Group
Texas Eastern Gas Pipeline Company
Texas Gas Transmission Corporation
Texas Oil & Gas Corporation
TransCanada Pipe Lines
Transcontinental Gas Pipe Line Corporation
United Gas Pipe Line Company
Valero Interstate Transmission Company
Valley Gas Transmission, Inc.
Westcoast Energy Inc.
The Williams Companies
Williston Basin Interstate Pipeline Company
Wintershall Corporation

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

1988 ASSOCIATE MEMBERS

AMAX Oil & Gas Inc.
Amoco Production Company
ARCO Oil and Gas Company
Atlanta Gas Light Company
The Brooklyn Union Gas Company
Chevron USA
Conoco Inc.
Entex, Incorporated
Exxon Company, U.S.A.
John H. Hill
Kerr-McGee Corporation
Kinsey Interests, Inc.
Laclede Gas Company
Lear Petroleum Exploration Company
Marathon Oil Company
Mewbourne Oil Company
Mobil Oil Corporation
National Fuel Gas Company
Northern Indiana Public Service Company
Oklahoma Natural Gas Company,
a Division of ONEOK Inc.
OXY USA Inc.
Pennzoil Company
Phillips Petroleum Company
Shell Oil Company
Southern California Gas Company
Sun Exploration & Production Company
Texaco U.S.A.
Union Pacific Resources Company
Unocal Corporation